



0000122373

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

JAN 6 2011

KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

DOCKETED BY

ne

IN THE MATTER OF THE APPLICATION OF
RIO RICO UTILITIES, INC. FOR A
DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANT AND PROPERTY AND
FOR INCREASES IN ITS WATER AND
WASTEWATER RATES AND CHARGES FOR
UTILITY SERVICE THEREON.

DOCKET NO. WS-02676A-09-0257

DECISION NO. 72059

OPINION AND ORDER

DATES OF HEARING:

March 10, 11, 12, 15 and 30, 2010

PLACE OF HEARING:

Tucson and Phoenix, Arizona

PUBLIC COMMENT:

June 2, 2010

PLACE OF PUBLIC COMMENT:

Nogales, Arizona

ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

IN ATTENDANCE:

Kristin K. Mayes, Chairman
Gary Pierce, Commissioner
Paul Newman, Commissioner

APPEARANCES:

Mr. Jay Shapiro, FENNEMORE CRAIG, PC, on behalf
of Rio Rico Utilities, Inc.;

Mr. Daniel Pozefsky, Chief Counsel, Residential Utility
Consumer Office;

Mr. Timothy Sabo, ROSHKA, DEWULF & PATTEN,
PLC, on behalf of Rio Rico Properties, Inc.; and

Ms. Robin Mitchell and Ms. Kimberly Ruht, Staff
Attorneys, Legal Division, on behalf of the Utilities
Division of the Arizona Corporation Commission.

BY THE COMMISSION:

I. INTRODUCTION

Rio Rico Utilities, Inc. ("RRUI" or "Company") provides water and wastewater service in and
near the community of Rio Rico, Arizona, in Santa Cruz County, Arizona. RRUI provides water

1 service to approximately 6,600 customers and wastewater service to approximately 2,200 customers.
2 Water customers who do not get wastewater service from RRUI utilize septic systems. RRUI's water
3 and wastewater divisions are both Class B utilities pursuant to A.A.C. R14-2-103.A.3.q.

4 In December 2005, RRUI became a wholly-owned subsidiary of Algonquin Water Resources
5 of America, Inc. ("AWRA"), which is currently known as Liberty Water, Inc. ("Liberty Water").
6 Liberty Water is a wholly-owned subsidiary of Algonquin Power Income Fund ("APIF").

7 APIF is an investment trust that owns, or has interests in, 71 companies in the United States
8 and Canada, including 41 hydroelectric facilities, five natural gas cogeneration facilities, and 15
9 water and sewer facilities.¹ In October 2009, APIF converted to a corporation known as Algonquin
10 Power and Utilities Corp. ("APUC"). In addition to RRUI, Liberty Water owns seven other utilities
11 in Arizona, including: Litchfield Park Service Company, Gold Canyon Sewer Company, Black
12 Mountain Sewer Corporation, Entrada Del Oro Sewer Company, Northern Sunrise Water Company,
13 Inc., Southern Sunrise Water Company, Inc., and Bella Vista Water Company. Liberty also operates
14 water and wastewater systems in Texas, Missouri and Illinois.

15 On May 21, 2009, RRUI filed an application for a permanent rate increase for its water
16 system and a rate decrease for its wastewater system, using a 12 month test year ending December
17 31, 2008. RRUI's current rates were authorized in Decision No. 67279 (October 5, 2004). This is
18 RRUI's first rate case since being acquired by Liberty Water.

19 RRUI states that it has made a number of significant plant improvements since the last rate
20 case. Its capital investments include the purchase in 2005 of an additional 100,000 gallons per day
21 ("gpd") of wastewater treatment capacity from the City of Nogales, at a cost of \$300,000, to bring its
22 current capacity to 550,000 gpd. RRUI states that the City of Nogales also required it to pay
23 \$427,000 toward the cost of upgrading the shared treatment facilities related to current capacity.
24 RRUI states that the upgrades are not related to any increased growth or additional planned flows in
25 the future. In addition, RRUI states it has two new wells, and has refurbished another, at a combined
26 total cost of more than \$1.6 million. The Company also states it added \$4 million in plant upgrades
27

28 ¹ APIF also has an operating interest in 8 facilities in which it does not have an ownership interest.

1 to the water division, including \$830,000 to increase storage and replace two booster stations at
2 Water Plant #1 in 2003; \$550,000 to replace the Water Plant #59 booster station's pumps, motors,
3 electrical controls and telemetry as the plant had reached the end of its useful life; and in 2008,
4 completed a \$1.1 million renovation of Water Plant #81, involving the replacement of a 25-year old
5 booster station and the addition of 1,000,000 gallons of storage in order to provide fire flows.

6 In the test year, RRUI reported adjusted gross revenues from its water division of \$1,847,256,
7 which according to the Company, resulted in an adjusted operating loss of \$173,579. Based on the
8 Company's schedules, in the test year the water division suffered a negative 2.17 percent rate of
9 return on an adjusted test year rate base of \$7,992,279.

10 RRUI is seeking a gross revenue requirement of \$3,652,884 for its water division, an increase
11 of \$1,805,628, or 97.75 percent, resulting in operating income of \$935,097, a rate of return of 11.70
12 percent on Fair Value Rate Base ("FVRB").

13 RRUI reported adjusted gross revenues for its wastewater division of \$1,829,976, which led
14 to operating income of \$474,319, a 14.27 percent rate of return on an adjusted rate base of
15 \$3,323,449.

16 For its wastewater division, the Company is requesting a gross revenue requirement of
17 \$1,690,768, a decrease of \$139,208, or 7.61 percent.

18 In addition, the Company proposes a low income tariff and a hook-up fee ("HUF") tariff for
19 both its water and wastewater divisions.

20 The Residential Utilities Consumer Office ("RUCO") recommends a rate increase for the
21 water division of \$957,929, an increase of 51.6 percent, from \$1,852,050 to \$2,809,979.² RUCO's
22 recommendations result in operating income of \$567,180, a rate of return of 7.9 percent on a rate
23 base of \$7,175,864.

24 For the wastewater division, RUCO recommends a revenue decrease of \$493,946, or 26.9
25 percent, from \$1,834,481 to \$1,340,535. RUCO's recommended revenue results in operating income
26 of \$235,852, a 7.9 percent rate of return on a rate base of \$2,983,957.

27
28 ² As discussed later, RUCO does not adjust test year revenues as did RRUI and Staff.

Staff recommends a gross revenue requirement of \$3,192,376 for the water division, an increase of \$1,345,120, or 72.8 percent, over test year revenues which results in operating income of \$718,412, a 9.2 percent rate of return on a FVRB of \$7,808,822.

Staff recommends a revenue decrease for the wastewater division of \$302,902, or 16.55 percent, from \$1,829,976 to \$1,527,074. Staff's recommended revenue requirement results in operating income of \$296,875 for the wastewater division, a 9.2 percent rate of return on FVRB of \$3,226,899.

The major contested issues in this proceeding were the treatment of accumulated deferred income taxes, the allocation of central office costs from APIF to RRUI, the cost of equity, rate design and the necessity for, and specific language in, a HUF tariff.

II. RATE BASE ISSUES

As reflected in their respective Final Schedules,³ RRUI's, RUCO's and Staff's proposed Original Cost Rate Bases ("OCRB") and FVRBs for the water division are as follows:

	<u>OCRB</u>	<u>FVRB</u>
RRUI	\$7,992,279	\$7,992,279
RUCO	\$7,808,822	\$7,808,822
Staff	\$7,175,864	\$7,175,864

The parties' recommended rate bases for the wastewater division are as follows:

	<u>OCRB</u>	<u>FVRB</u>
RRUI	\$3,323,449	\$3,323,449
RUCO	\$3,226,899	\$3,226,899
Staff	\$2,983,957	\$2,983,957

The only rate base issue in dispute involves the calculation of deferred income taxes.

A. Accumulated Deferred Income Tax

Accumulated deferred income taxes ("ADIT") reflect the timing difference between when income taxes are calculated for ratemaking purposes and the actual federal and state income taxes that are paid by the Company. The timing difference is primarily due to the fact that straight line depreciation is used for ratemaking purposes, whereas the Company utilizes accelerated depreciation

³ RRUI Final Schedule B-1; RUCO Final Schedule TJC-2 at 1; Staff Final Schedule GWB-1.

for income tax reporting purposes.

The National Association of Regulatory Utility Commissioners Uniform System of Accounts ("NARUC USOA") requires utilities to use straight line depreciation. In the early years of an asset's life, straight line depreciation typically results in a lower depreciation expense, which results in a higher operating income and thus, a higher income tax, than under the accelerated depreciation methodology used for tax purposes. The Internal Revenue Service ("IRS") Code allows companies to use accelerated depreciation for preparing their taxes, which in the early years of an asset's life typically results in a higher depreciation expense, and lower income taxes. Tax depreciation also may result from tax law changes or bonus depreciation, among other things.⁴ In the later years of an asset's life, the effect of the differences in the book and tax depreciation expenses reverse, and eventually, the ADIT balance reduces to zero when the asset is fully depreciated under straight line depreciation.⁵

Normalization is the inter-period allocation of the income tax effects of accelerated depreciation deductions, the investment tax credit and the alternative minimum tax for regulatory ratemaking purposes. "Normalization" involves: (1) setting up a deferred tax reserve for the difference between straightline depreciation expense used in rate making and the accelerated method used for calculating tax expense on income tax returns; and (2) drawing down that reserve in later years as the accelerated depreciation benefits reverse.⁶

The parties' ADIT calculations for the water and wastewater divisions are as follows:⁷

	<u>Water</u>	<u>Wastewater</u>
RRUI	\$314,965	\$130,973
RUCO	(\$501,450)	(\$208,519)
STAFF	\$82,782	\$34,423

A deferred liability is created when a company has paid less in taxes because of accelerated or bonus depreciation than is calculated for ratemaking purposes. An ADIT liability is a deduction from

⁴ Hearing Transcript ("Tr.") at 109, 111.

⁵ Ex S-6, Becker Dir. Testimony at 12.

⁶ Staff's Opening Brief at 5.

⁷ Positive balances represent an asset and an addition to rate base, while a negative balance represent a liability and deduction from rate base.

1 rate base. A deferred asset is created when the rate-making depreciation expense is greater than the
2 deprecation expense for tax purposes. Staff and RRUI agree with the basic methodology for
3 calculating ADIT, however Staff and the Company disagree about the components that comprise
4 ADIT.⁸ Staff and the Company calculate a debit ADIT balance, while RUCO calculates a credit
5 ADIT.⁹

6 **1. RRUI's Position**

7 RRUI asserts that ADITs are critical to the ratemaking process and if not properly calculated
8 and reflected in the ratemaking formula, will cause ratepayers to either pay too much or too little.
9 RRUI argues that whether an ADIT asset or liability is created, the use of the money or the loss of the
10 use of money should be recognized in rate base, much the same way working capital is recognized in
11 rate base.¹⁰

12 Mr. Bourassa, RRUI's witness on this issue, calculated ADIT using the same methodology he
13 utilized in other Liberty Water rate cases, including the Black Mountain Sewer case. The Company
14 proposed three components for ADIT: 1) the tax benefits associated with the differences between the
15 book and tax treatment of fixed assets and associated depreciation; 2) the tax benefits associated with
16 the net Advances in Aid of Construction ("AIAC") on its books; and 3) the tax benefits of net
17 operating loss carry forwards ("NOL").

18 RRUI argues that Staff's opposition to the inclusion of the NOL in the ADIT calculation is
19 unexplained and irrelevant because the NOL arose from special "bonus" depreciation allowed during
20 the test year, a one time "take it or lose it" tax opportunity, which was never reflected in the
21 Company's rates.¹¹ Thus, according to RRUI, ratepayers have not yet paid rates associated with the
22 NOL. RRUI argues that recognizing the special depreciation and related tax timing differences is
23 necessary in order to be consistent and protect future tax benefits. It argues the NOL is also fairly
24 considered in the ADIT calculation because taking the special depreciation lowers the amount of the
25 asset which lowers rate base and because it could provide future tax benefits to RRUI and its
26

27 ⁸ Tr. at 910.

⁹ Staff Final Schedule at GWB-4.

¹⁰ RRUI Initial Closing Brief at 10.

¹¹ Tr. at 117-118, 912; Ex A-6 Bourassa Reb. At 11-12.

1 ratepayers.

2 With respect to Staff's disallowance of \$105,049 on the grounds there is "unidentified" plant,
3 RRUI argues that the fact that the specific plant item could not be identified does not mean the
4 calculation is tainted. RRUI argues Staff provided no explanation as to why it believes the
5 calculation to be erroneous, and that the ADIT calculation was reconciled to the Company's books
6 and records. RRUI argues that to adopt Staff's adjustment would create a further mismatch.

7 RRUI argues that RUCO's methodology of allocating the parent company's ADITs based on
8 RRUI's stock acquisition price in 2005 was rejected by the Commission in the 2006 Black Mountain
9 Sewer rate case (Decision No. 69164).¹² RRUI argues that RUCO's methodology is neither
10 systematic nor rational because it uses a third-party allocation when utility-specific information is
11 available. RRUI states there is no reason to allocate deferred taxes from the parent because RRUI's
12 books and records are available and a deferred income tax calculation can be made for RRUI.

13 **2. RUCO's Position**

14 RUCO argues that pursuant to the Statement of Financial Accounting Standards ("SFAS")
15 No. 109 issued in February 1992, because the parent company shows an ADIT liability, RRUI too
16 must recognize an ADIT liability. RUCO cites SFAS No 109 which provides: "[t]he consolidated
17 amount of current and deferred tax expenses for a group that files a consolidated tax return shall be
18 allocated among the members of the group when those members issue separate financial statements."
19 SFAS No. 109 states further:

20 **Separate Financial Statements of a Subsidiary**

21 40. This Statement does not require a single allocation method. The
22 method adopted, however, shall be systematic, rational, and consistent
23 with the broad principles established by this Statement. A method that
24 allocates current and deferred taxes to members of the group by applying
25 this Statement to each member as if it were a separate taxpayer meets
26 those criteria. . . ¹³

27 RUCO allocated the consolidated ADIT balance to RRUI by dividing RRUI's total asset cost
28 (\$8.8 million) by APIF's total assets (\$978.1 million) to arrive at RRUI's asset ratio, and share of the
consolidated ADIT balance. RUCO claims that its methodology allocates current and deferred taxes

¹² Tr. at 859-860.

¹³ Ex Ruco-9 at 30.

1 to RRUI as if it were a separate taxpayer, and thus, meets the criteria established in SFAS No. 109.
2 RUCO asserts the RRUI ratepayers are entitled to the tax benefits which RUCO claims RRUI
3 contributed to as part of the APIF group.¹⁴

4 RUCO asserts that normally a utility's ADIT balance is a credit, or liability, because usually,
5 early in an asset's life, customers are paying more in rates for income taxes than the Company
6 actually pays.¹⁵ RUCO believes that RRUI's proposed ADIT asset raises a "red flag" because: (1) the
7 Company has recently spent over \$4 million in new assets, which are still in the early years of their
8 depreciable lives; (2) RUCO finds the AIAC balances that comprise part of the ADIT calculation to
9 be suspect; and (3) the balance sheet filed with the application did not show an ADIT balance and the
10 Company's 2008 Annual Report indicated the parent had a \$72,985 ADIT liability.¹⁶ RUCO asserts
11 that the "unusual number of mistakes, modifications and changes to the numbers" calls into question
12 the accuracy of the Company's calculations and final recommendations.¹⁷ Furthermore, RUCO
13 believes that the magnitude of the change in the Company's ADIT position between direct testimony
14 (\$1,101,805 for both divisions) to its rebuttal position (\$445,938) argues for giving the Company's
15 final recommendation little weight.

16 RUCO states that both the Company and Staff calculate ADIT based on a 100 percent
17 probability that AIAC will be refunded. RUCO argues, however, that the Company's records show
18 that its water division refunded less than 20 percent of two different AIAC accounts over a nine year
19 period. Thus, RUCO argues that the Company has failed to meet its burden to prove that 100 percent
20 of the AIAC will be refunded for tax purposes so that the Company will realize the tax benefit it
21 proposes.

22 3. Staff's Position

23 Staff uses the same methodology for calculating ADIT as the Company, except that Staff
24 does not include the tax loss carryforwards.

25 RRUI's and Staff's recommended ADIT components are as follows.¹⁸

26 ¹⁴ RUCO Brief at 7.

27 ¹⁵ Ex S-6 at 13.

¹⁶ RUCO Closing Brief at 3-4.

¹⁷ RUCO Closing Brief at 4.

28 ¹⁸ Ex S-7 Becker Surrebuttal at 17.

	<u>RRUI</u>	<u>Staff</u>
Fixed Asset Component	\$18,681	(\$21,868)
AIAC Component	\$139,073	\$139,073
NOL Component	<u>\$288,183</u>	<u>0</u>
Total	\$445,238	\$117,205

Staff claims that normalizing NOLs is not required by the tax code. According to Staff, normalization provides regulated utilities with an incentive to invest because of the treatment of accelerated depreciation. Staff states that Congress has repeatedly said that the purpose of accelerated depreciation is to encourage capital investment at the corporate level, not to lower utility rates for consumers.

Staff believes that it is not appropriate to include NOLs in the ADIT calculation. Staff testified that the NOL represents losses incurred by the Company when it failed to earn taxable profit in previous years.¹⁹ Staff could not find any authority for, or requirement to, include NOLs in the calculation of ADIT.²⁰ Staff believes that to include NOLs in ADIT would be unfair to ratepayers because ratepayers would essentially be paying a carrying charge on the Company's expected future recovery of a tax benefit while the ratepayers have already paid their share of income tax expense in rates.²¹ Staff asserts further that the NOLs are not the result of book versus tax timing differences, but represent a tax loss that can be carried forward to offset taxable income in future years. Staff's witness, Gerald Becker, testified that the parent company already turned these NOLs into cash less than 12 months after the end of the test year.²² Staff believes that its recommended treatment of ADIT is fair to the Company and to its ratepayers.

4. Resolution

The methodology employed by Staff and the Company for the calculation of ADIT is appropriate and consistent with past Commission practice.²³ The Commission has rejected RUCO's position that the ADIT calculation should always result in a net liability, and has found that when there is significant funding of plant with Contributions in Aid of Construction ("CIAC") and AIAC,

¹⁹ Ex S-6 at 19.

²⁰ Tr. at 915-16.

²¹ Ex S-6 at 19; Ex S-7 at 16.

²² Tr. at 917; Staff's Reply Brief at 4.

²³ Decision No. 69164 (December 5, 2006) at 5-6; Decision No. 71865 (September 1, 2010).

1 the ADIT calculation can often result in a net ADIT asset.²⁴ When Company-specific information is
2 available to calculate an entity's deferred tax balances, it is not necessary to resort to the allocation
3 methodology RUCO advocates. RRUI is only a small component of the APIF family of businesses
4 all of which have unique tax circumstances which contribute to the parent company's consolidated
5 tax position. There is no direct nexus between the parent's consolidated ADIT balance and RRUI's
6 which would indicate that utilizing RUCO's allocation methodology is fair to ratepayers or
7 shareholders.

8 Normally, when a Company makes substantial new plant investments and is able to take
9 advantage of accelerated depreciation for tax purposes, one would expect to see an ADIT liability
10 because the Company has been able to reduce its actual tax payments compared to the expense that
11 was assumed for ratemaking purposes. To compensate ratepayers for the tax benefits the Company
12 was able to achieve, an ADIT liability reduces rate base, and hence, rates. However, as Mr. Becker
13 explains, a future tax benefit is created when the Company pays taxes on AIAC received.²⁵ A
14 temporary difference, i.e. an ADIT balance, is created when the Company pays taxes before it makes
15 any AIAC refunds. This creates a tax basis in the constructed plant and the Company is entitled to
16 record tax basis depreciation on that plant.²⁶ When a Company finances a significant amount of its
17 plant with AIAC, as is the current case, an ADIT asset balance is not unexpected.

18 Even though they agree on the general methodology for calculating ADIT, Staff and the
19 Company disagree about 1) the inclusion of \$105,409 in plant for which the Company could not
20 provide invoices; and 2) the inclusion of the NOL. The NOL results from bonus depreciation that
21 was available in the test year, but is itself not a tax timing difference. The Company could not utilize
22 all of the bonus depreciation in the test year, which resulted in a carry forward of the tax benefit. The
23 NOL carry forward benefits the parent company, which it appears has already utilized it to reduce its
24 tax liability. We agree with Staff that the Company has not provided any authority for including the
25 NOL in the ADIT calculation nor demonstrated why it is fair to RRUI's ratepayers to pay a return on
26 the NOL which the parent can use to offset future years' taxable income.

27 ²⁴ *Id.*

28 ²⁵ Ex S-6 Becker Direct at 11.

²⁶ Ex S-6 at 18.

We also agree with Staff concerning the \$105,049 in plant that could not be verified. It is the Company's burden to demonstrate that its ADIT calculation is appropriate, but by its inability to identify specific plant items, it has not met its burden with respect to the plant balances. Plant balances varied significantly throughout the course of this proceeding, as did the resultant ADIT balances. The Company argues that it is immaterial that the specific invoice(s) for one or more plant items totaling \$105,409 could not be located as "Staff agrees the plant is there because it does not dispute the amount of the ADIT calculation."²⁷ However, Staff is disputing the ADIT calculation. We adopt an ADIT balance as follows:

Fixed Asset Component	(\$21,868)
AIAC Component	\$139,073
NOL Component	<u>0</u>
Total	\$117,205

Of the total ADIT asset, 70.63 percent, \$82,781, is allocated to the water division, and 29.37 percent, \$34,423, to the wastewater division.

B. Rate Base Summary

RRUI did not prepare schedules showing the elements of reconstruction cost new depreciated ("RCND") and, instead requested that the OCRB be treated as its FVRB.²⁸

Based on the foregoing discussion, we adopt an adjusted OCRB and FVRB of \$7,808,822 for RRUI's water division and \$3,226,898 for RRUI's wastewater division as follows:

Commission Approved

Water Division

Plant in Service	\$34,059,804
Less: Accumulated Depreciation	<u>\$12,423,937</u>
Net Plant in Service	\$21,635,867
Deductions:	
CIAC	\$20,140,197
Less Accumulated Amortization	<u>\$ 6,628,197</u>
Net CIAC	\$13,512,000
AIAC	\$ 122,372
Customer Deposits	\$ 275,455
ADIT	(\$ 82,782)

²⁷ RRUI Reply closing Brief at 2.

²⁸ RRUI Final Schedules

1	Additions:	
2	Deferred Regulatory Assets	
3	Pre-payments	
3	Cash Working Capital	<hr/>
4	Total OCRB	\$ 7,808,822
5	<u>Wastewater Division</u>	
6	Plant in Service	\$11,829,041
7	Less: Accumulated Depreciation	<u>\$ 5,110,028</u>
7	Net Plant in Service	\$ 6,719,013
8	Deductions:	
9	CIAC	\$ 5,137,674
9	Less Accumulated Amortization	<u>\$ 1,944,057</u>
10	Net CIAC	\$ 3,193,617
11	AIAC	\$ 237,921
11	Customer Meter Deposits	\$ 95,000
12	ADIT	\$ (34,423)
13	Additions:	
13	Deferred Regulatory Assets	
14	Pre-payments	
14	Working Capita	<hr/>
15	Total OCRB	\$ 3,226,898

16 III. INCOME STATEMENT

17 RRUI and Staff agree on the Company's Test Year Revenues of \$1,847,255 for the water
 18 division and \$1,829,976 for the wastewater division. RUCO did not accept the Company's adjusted
 19 test year revenue, and removed the Company's proposed revenue annualization adjustment which
 20 was based on end-of-test year customer counts. RUCO recommends test year revenues of \$1,852,050
 21 for the water division, a reduction of \$4,784, and revenues of \$1,834,481 for the wastewater division,
 22 an increase of \$4,505.

23 The major area of disagreement involving income statement items is how to allocate the
 24 central office costs of RRUI's parent. The Company's allocation method has been at issue in the
 25 pending rate cases of RRUI's sister companies Black Mountain Sewer Company (Docket No. SW-
 26 02361A-08-0609),²⁹ Litchfield Park Service Company (Docket No. SW-01428A-09-0103), and
 27

28 ²⁹ Decision No. 71865 (September 1, 2010).

1 Bella Vista Water Company, Northern Sunrise Water Co. and Southern Sunrise Water Co. (Docket
2 No. W-02465A-09-0411 et al).

3 **A. Revenue Annualization**

4 **1. RRUI's Position**

5 The Company annualized revenues to reflect test year end customer counts, which resulted in a
6 slight downward adjustment to test year revenues for both divisions. Staff accepted the revenue
7 annualization without adjustment, but RUCO did not.

8 The Company asserts that no one can know whether the decline in water revenues that started
9 during the test year is permanent. The Company testified that in 2009, there was an even more
10 substantial revenue decline than in the test year.³⁰ RRUI argues that there is no basis to deviate from
11 traditional rate making which adjusts revenues to test-year-end customer counts, and that the
12 adjustment proposed by RRUI, and accepted by Staff, is not "overstated."³¹

13 **2. RUCO's Position**

14 RUCO opposed the revenue annualization for the 5/8-inch meter. RUCO states that the
15 Company has experienced a small level of customer growth from year to year, and a downward
16 adjustment would understate test year revenue as well as future years' revenue.³² RUCO accepted the
17 annualization of revenues to reflect the test-year-end for all customers except the residential
18 customers.

19 **3. Resolution**

20 The relatively minor adjustment to test year revenues results from the standard ratemaking
21 practice of annualizing revenues based on end of the test year customer numbers. We are not
22 persuaded that there is reason in this case to deviate from this practice. Furthermore, 2009 results
23 appear to validate a decline in revenues. Consequently, we adopt the Company's and Staff's adjusted
24 test year revenues for both divisions.

25 **B. Central Office Cost Pool Allocation**

26 RRUI is one of seven Arizona utilities wholly-owned by Liberty Water, which in turn, is

27 ³⁰ Tr. at 151.

28 ³¹ RRUI Initial Closing Brief at 37.

³² RUCO Brief at 10.

1 owned by APIF. APIF's primary business is owning generating and infrastructure facilities. APIF
2 owns 46 electric facilities and 17 water distribution and wastewater treatment facilities in Canada and
3 the United States. APIF also has an operating interest in 8 other facilities, but does not own them.
4 APIF is publicly traded on the Toronto Stock Exchange ("TSX").³³ Its head office is located in
5 Oakville, Ontario, Canada.

6 RRUI and the other regulated utilities in Arizona do not operate as stand-alone utilities.
7 Liberty Water provides the day-to-day administration and operations personnel for the regulated
8 utilities. Liberty Water charges its labor rates at cost, which is the dollar hourly rate per employee as
9 recorded in Liberty Water's payroll system, grossed up by 35 percent for burdens such as payroll
10 taxes, health benefits, retirement plans, and other insurance provided to employees. Engineering
11 technical labor, which is capitalized, is charged on the same basis, plus an allocation of 10 percent for
12 Liberty Water's corporate overheads such as rent, materials/supplies, etc.³⁴

13 Other necessary services provided by Liberty Water such as labor for accounting, billing and
14 customer service, human resources, health and safety, and corporate finance cannot be directly
15 allocated using timesheets because the nature of the costs makes it impractical to keep track of time
16 for employees that serve multiple utilities in small time increments during the course of a workday.
17 These costs are allocated based on the relative customer counts of all of the regulated utilities.
18 Liberty Water believes this methodology allows it to allocate these costs to an individual utility based
19 on the relative burden of each utility.³⁵

20 Liberty Water's overhead costs, like rent, insurance, administration costs, depreciation of
21 office furniture and computers also cannot be directly attributed to specific utilities. These costs are
22 allocated to RRUI, and the other utility affiliates, based on a "four factor" methodology that considers
23 relative size through four weighted factors—total plant, total customers, expenses and labor.

24 All of the costs charged by Liberty Water and allocated to RRUI are based on actual costs,
25 either directly charged or through the allocations described above.³⁶

27 ³³ Ex A-10, Eichler Rebuttal at PE-RB-1.

28 ³⁴ Ex A-10 at PE-RB-1.

³⁵ *Id.*

³⁶ *Id.*

In addition to the operations and engineering direct costs and the allocated overhead/administration costs charged by Liberty Water, RRUI, and the other utilities, are charged costs incurred by APIF. APIF allocates to its affiliates a share of the costs incurred by its operating arm, Algonquin Power Trust ("APT"). APT provides financial, strategic management, compliance, administration and support services to APIF and its regulated and unregulated affiliates.

There is no dispute in this proceeding concerning either the amount, or the allocation methodology that is used to charge Liberty Water's costs to its affiliates, including RRUI. There is substantial disagreement, however, concerning the allocation of the APT Central Office Costs.

A comparison of the parties' final position on the APT Central Office Costs to be allocated to RRUI is set forth below:

	<u>RRUI</u>	<u>RUCO</u>	<u>Staff</u>
Audit	\$ 32,541	\$ 8,012	\$ 1,313
Tax Services	8,322	2,529	169
Legal	8,697	2,447	973
Other Professional Services	10,854		
Management Fee-total	21,671		
Unit Holder Communications	7,375		
Trustee Fees	4,356		
Escrow & Transfer Agent Fees	2,412		
Rent	10,100		
License Fees & Permits	291		
Office Expenses	22,595		
Depreciation	<u>6,841</u>	<u>1,657</u>	<u>272</u>
Total	\$136,706	\$14,645	\$2,728

Of the total, RRUI allocates \$102,960 to the water division and \$33,746 to the wastewater division.³⁷ RUCO allocates \$10,376 to the water division and \$4,270 to the wastewater division.³⁸ Staff allocates \$2,039 to the water division and \$688 to the wastewater division.³⁹

1. RRUI's Position

The Company states that APT's only business is to provide services to the facilities and

³⁷ RRUI Final Schedules, wastewater Sch C-2, at 8, water Sch C-2 at 10.

³⁸ RUCO Final Schedules, TLC-15, TJC-16.

³⁹ Staff's Final Schedules, GWB-20, see note.

1 utilities owned by APIF, and that all of the APT costs, which include professional services, like third-
 2 party legal, accounting, tax, and auditing, are indirect costs that benefit RRUI. The APT costs
 3 include costs for licenses, fees and permits, IT, personnel, payroll, and maintenance contracts as well
 4 as rent and depreciation of office furniture and equipment and computers in the Oakville central
 5 office. The Company asserts that as "indirect costs" they cannot be directly charged to a specific
 6 utility or affiliate.

7 RRUI's final position is that the APT Central Office Cost Pool is \$3,970,127.⁴⁰ The
 8 Company allocates 26.98 percent of the cost pool to Liberty Water, based on the percentage of
 9 Liberty Water's utilities (17) to APIF's total number of owned facilities (63) ($17/63 = 26.98$ percent).
 10 The other 73.02 percent is allocated to APIF and its unregulated facilities. The Liberty Water share
 11 of the Central Office Pool is then allocated to its 17 regulated utilities based on customer count.
 12 Thus, RRUI's water division receives 9.55 percent of Liberty Water's share of the APT costs, and
 13 RRUI's wastewater division receives 3.15 percent of Liberty Water's share of the APT costs.

14 The Company asserts that APIF considered other ways of allocating the APT costs.
 15 According to the Company, using revenues to allocate the costs, the regulated utilities would receive
 16 17.02 percent of the costs; using operating costs, the regulated utilities would receive 28.87 percent
 17 of the total costs, and using plant values, the regulated utilities would receive 29.74 percent of the
 18 APT costs.⁴¹ The Company reports that when weighted equally, the different methodologies result in
 19 a 24.96 percent allocation factor to Liberty Water. Based on the foregoing, the Company believes its
 20 26.98 percent allocation factor is reasonable, but would agree to adopt a blended methodology if the
 21 Commission feels it would be preferable.⁴²

22 The Company reports that APT provides four types of services to RRUI: (1) Strategic
 23 Management which includes management fees, general legal services and other professional services;
 24 (2) Capital Access, which includes licenses/fees/permits, unit holder communications and escrow
 25 fees; (3) Financial Controls, which includes audit services, tax services and trustee fees; and (4)

26
 27 ⁴⁰ Company Final Schedule C-2, page 10 (water) and page 8 (wastewater). According to the Company, these costs reflect
 Staff's position on exchange rates and have been converted to U.S. dollars based on the monthly average exchange rate
 from the Bank of Canada for the month each invoice was received by APT.

28 ⁴¹ RRUI Initial Closing Brief at 29.

⁴² *Id.*

1 Administrative/Overhead Costs, including rent and depreciation.⁴³ The Company claims that each of
2 these categories of APT costs provides substantial benefits to RRUI through access to capital markets
3 and strong corporate governance.

4 During the course of the proceeding, the amount of the cost pool fluctuated significantly as
5 the parties identified specific charges that they believed should not be included in the cost pool.
6 RRUI asserts that the final cost pool includes only costs that are reasonably necessary to provide
7 service to RRUI, and that it removed charges that were directly chargeable to one of the unregulated
8 facilities or otherwise not appropriately recovered from ratepayers (e.g. the hootenanny). RRUI
9 asserts further that neither Staff nor RUCO has identified any additional charges that should be
10 removed from the pool.⁴⁴

11 RRUI argues that in this proceeding it has shown that the APT Central Office Costs were
12 actually incurred, that the costs are reasonable (\$1.40/month/customer) and that the APT costs are
13 necessary expenses under RRUI's business model.⁴⁵ RRUI argues that it is unlikely APT can
14 continue to provide financial capital, tax services, audit services, fiscal controls and management to
15 RRUI based on the amounts Staff and RUCO recommend be allocated to RRUI.

16 RRUI states that the Commission has not adopted any standards or rules governing affiliate
17 cost allocations and thus, the review of the cost pool is an "organic process" that necessitates "give
18 and take" to refine and improve cost allocations based on Staff's and RUCO's concerns. RRUI
19 asserts it is unfair, and violates due process to deny the APT costs based on undisclosed standards.⁴⁶
20 RRUI claims that it provided access to any and all invoices but neither Staff nor the Commission has
21 ever stated what type of documentation would satisfy their concerns. RRUI also asserts that Staff is
22 applying a different standard to Liberty Water than it does to other Arizona utilities employing a
23 shared services model.

24 RRUI argues that as a matter of law, it is improper for Staff or RUCO to presume that the
25 majority of APT costs should be disallowed without supporting evidence. RRUI claims that the
26

27 ⁴³ Ex A-10, Eichler Rebuttal at 13-17, Exhibit PE-RBI at 7-15.

⁴⁴ RRUI Closing Brief at 15-16.

⁴⁵ Ex. A-10 Eichler Rebuttal at 22-37; Ex A-11 Eichler Rejoinder at 4-8; Tr. at 226-227.

28 ⁴⁶ RRUI Closing Brief at 16.

Commission has found that while affiliate cost allocations must be scrutinized, there may not be a “presumptive disallowance of all costs incurred as a result of transactions with affiliates.”⁴⁷ The Company complains that Staff’s and RUCO’s witnesses are merely expressing their beliefs that the APT costs do not benefit ratepayers. RRUI argues that speculation and arbitrary conclusions do not meet the substantial evidence test for their disallowance. In addition, the Company asserts that Staff and RUCO apply the wrong ratemaking standard and fail to recognize that the APT costs are necessary under the Liberty Water business model.⁴⁸ RRUI claims that Staff did not apply the “stand alone” test that Staff appears to advocate in this case to other Arizona utilities with a shared cost model.⁴⁹

According to RRUI, the average customer cost per month for the APT Central Office Costs is \$1.42/month for RRUI’s water customers and \$1.36 for RRUI’s sewer customers. RRUI argues that neither Staff nor RUCO disputed the testimony or evidence of the operating cost comparison,⁵⁰ which RRUI believes demonstrates that RRUI’s operating costs per customer for its water division are below those of comparable companies and for the wastewater division, are in the range of the comparable sewer companies.⁵¹ RRUI argues that customers get many services and benefits for the modest cost associated with APT, including strategic management service and continued access to capital which prevent financial and service problems experienced by other stand-alone utilities.

Liberty Water states that it is willing to provide an independent attestation of the APT cost pool. The NARUC Guidelines state: “any jurisdictional regulatory authority may request an independent attestation engagement of the [Cost Allocation Manual].”⁵² RRUI states that to the extent the Commission, Staff and/or RUCO are concerned about whether the final APT cost pool includes charges relating to unregulated business operations or reflect services that can’t be verified from invoices, upon approval of the APT costs, Liberty Water and RRUI are willing to provide an “Attestation Engagement” to verify the contents of the cost pool.

⁴⁷ Decision No. 55931, Arizona Public Service Company, 91 P.U.R. 4th 350 (April 1, 1988).

⁴⁸ RRUI Closing Brief at 24.

⁴⁹ E.g., Arizona American, Arizona Water Company and Chaparral City Water Company.

⁵⁰ Ex A-12, Tr. at 222-223.

⁵¹ Ex A-10, Eichler Rebuttal at 21, Ex PE-RB3, Ex A-11 Eichler Rejoinder at Ex PE-RJ1, PE-RJ2 and PE-RJ3; Tr at 216-220.

⁵² Ex S-3 at 4 ¶E(3).

2. RUCO's Position

RUCO rejected most of the costs in the Company's proposed cost pool on the grounds that RUCO believes that the vast majority of the items in the cost pool are unrelated to providing service to RRUI.⁵³ After numerous revisions, RUCO believes that the final cost pool remains "highly suspect," and that the Company has not met its burden to demonstrate that the costs included in the cost pool should be allocated to RRUI's ratepayers.⁵⁴

RUCO argues that only a fraction of the costs appear to be necessary to provide service to RRUI's customers. Given the lack of detail of the invoices, RUCO recommends that the Commission allow no more than 25 percent of the audit, tax services, legal, and depreciation expenses, and disallow all other APT expenses.⁵⁵ RUCO alleges that the remaining expenses are more appropriately attributed to APIF's other operating activities and borne by shareholders. RUCO allows \$466,837, which represents 25 percent of the costs related to audit, tax services, legal and depreciation. RUCO then allocates 24.29 percent of this subset of costs to the Liberty Water entities. Of the Liberty Water allocation, RUCO allocates 12.92 percent, or \$14,645, to RRUI.

RUCO asserts that it is the Company's burden to show that the expenses in the cost pool are necessary for the provision of service to RRUI ratepayers, and that the Company's failure to do so in RUCO's view, should result in rejecting the Company's recommendation.⁵⁶ RUCO asserts that there is nothing in the NARUC Guidelines that shifts the burden to Staff to prove costs should not be included in the cost pool. In addition, RUCO asserts that RRUI's offer of an independent attestation is not helpful after the hearing has been held.

3. Staff's Position

Staff states that it is not opposed to a shared services model, and notes that it has allowed the allocation and recovery of Liberty Water's expenses. Staff argues, however, that some of the costs the Company included in the APT Cost Pool have nothing to do with providing utility service to RRUI's ratepayers. After reviewing the costs, Staff believes that the central office costs were

⁵³ RUCO Closing Brief at 9.

⁵⁴ *Id.*

⁵⁵ Ex RUCO-9 at 25.

⁵⁶ RUCO Brief at 10.

1 incurred primarily for the benefit of the APIF shareholders.⁵⁷ Consequently, Staff assigned 90 percent
2 of the APT costs to APIF. Staff assigns the remaining 10 percent to APIF's affiliates, recognizing
3 that the affiliates receive some benefit from the common costs. Staff allocated 10 percent of the
4 costs for audit, tax services, legal and depreciation to the 70 APIF entities (a total of \$190,931) Staff
5 then allocated 1.43 percent, or \$2,728, to RRUI from these four categories of services.

6 The correct number of companies that are used to calculate the allocation factor is at dispute.
7 Staff recommends an allocation factor of 1/70 or 1.43 percent based on a total of 70 facilities. Staff
8 based its facility count on a review of the APIF 2008 annual report which lists 70 facilities owned by
9 APIF.⁵⁸ RRUI uses a total facilities count of 63, representing the facilities in which APIF only has an
10 equity interest.⁵⁹

11 Staff states that the NARUC Guidelines for Cost Allocations and Affiliate Transactions
12 require that costs primarily attributable to a business operation should be directly assigned to that
13 business operation to the extent possible. Staff reviewed the underlying invoices of the costs being
14 allocated and determined that the Company did not identify the costs as direct or indirect to be
15 consistent with the NARUC guidelines.⁶⁰ Staff asserts that the amounts allocated to the regulated
16 entities should not be in excess of the amounts that the regulated entity would incur on a stand alone
17 basis.⁶¹ Staff states that when costs incurred primarily for the benefit of an unregulated affiliate's
18 business are improperly identified and allocated as overhead/common costs, then costs of the
19 unregulated affiliate are shifted to the captive customers of the regulated utility. Staff states that such
20 cost shifting would result in the customers of the utility subsidizing the business operations of the
21 unregulated affiliate to the harm of the ratepayers. Staff urges the Company to review its cost pool
22 and only include those expenses that are necessary to provide services to the ratepayers.

23 Staff asserts that the Company misapplies the standard for recovery of reasonable and prudent
24 expenses. Staff argues that only expenses necessary to the conduct of the utility business, not those
25 incurred for Algonquin's other business segments, are appropriately allocated and recovered from

26 ⁵⁷ Ex S-7 at 13.

27 ⁵⁸ Ex S-6 at 31.

⁵⁹ Tr. at 231-33.

⁶⁰ Staff Initial Brief at 8.

28 ⁶¹ *Id.*

1 ratepayers. Staff asserts that even if the APT costs are necessary for APIF to do business, they can be
2 denied if the costs are more appropriately borne by the APIF shareholders.

3 **4. Resolution**

4 Although shared services models can be an efficient method to operate utilities and can
5 provide benefits to utility ratepayers that might not be able to be obtained if the utility were operating
6 on a stand alone basis, it is important that the Commission carefully review the shared costs that are
7 being sought from ratepayers. The utility is a captive of its parent, and may not have recourse to
8 dispute charges incurred at the parental level and allocated to it, just as ratepayers are the captives of
9 the utility. The Commission must scrutinize the common costs and allow only those costs which
10 provide a benefit to the utility ratepayers. As we noted in the Black Mountain Sewer rate case, the
11 standard for what the utility would have incurred as a stand alone entity may not necessarily be the
12 standard for allowing the recovery of common costs.⁶² The common costs must be reasonable based
13 on the size of the utility. The entity seeking recovery must show that the type of cost and the amount
14 allocated to the utility are reasonable and reasonably necessary for the provision of utility service.
15 What the utility would need to pay on a stand alone basis may provide a check on the reasonableness
16 of the expense.

17 A shared services model can provide benefits to ratepayers when being affiliated with a larger
18 entity allows a relatively small utility to access capital or provide a level of services that may
19 otherwise be difficult for a small utility to obtain or provide on a stand alone basis. One of the great
20 benefits to RRUI from being part of the APIF family is the access to capital that the parent is able to
21 provide. Although ratepayers were opposed to the magnitude of the requested increase, they did not
22 generally complain about the quality of service after Liberty Water acquired the system. Liberty
23 Water has been able to invest in RRUI and make needed capital improvements.

24 APT's activities related to being listed on the TSX provide benefit to the RRUI ratepayers.
25 Some of the APT costs, however, are more appropriately allocated only to the shareholders or the
26 unregulated entities. For example, the management fees are related to the management of APIF and
27 there is no evidence documenting the time the APT managers spent providing strategic planning, or

28 ⁶² Decision No. 71865 at 24.

1 other services, to the regulated utilities. Liberty Water provides strategic planning for RRUI and we
2 are not convinced that the additional oversight and strategic planning attributed to the APT
3 management fees are necessary for RRUI to provide service, or are reasonably allocated to the
4 regulated utilities. In a future rate case, with additional evidence, the Company may be able to meet
5 its burden to demonstrate that the APT management fees costs provide real, non-duplicative benefits
6 to RRUI ratepayers, but we find that the Company has not met its burden in this case. As we have
7 found in the past, we continue to hold that escrow, trustee fees and shareholder communication fees
8 are activities that primarily benefit shareholders and are appropriately disallowed for ratemaking
9 purposes.

10 We find that the APT costs that are necessary for APIF to be listed on the TSX provide a
11 direct benefit to RRUI, as they enable RRUI to receive the benefits of APIF's access to capital
12 markets. Thus, we find that the costs related to audit, tax services, legal and license fees and permits
13 should be allocated to RRUI. The amount of the costs in each category has been sufficiently
14 reviewed and the invoices that should have been removed, have been removed from the pool. Thus,
15 in this case, we will allow APT central costs related to audit, tax, legal, and license fees and permits
16 to be allocated to RRUI as set forth below.

17 We continue to find the methodology adopted in the Black Mountain Sewer case to be
18 reasonable.

- 19 1. Allowable common APT expenses for RRUI in this case shall be limited to
20 audit, tax, legal and license fees and permits;
- 21 2. The allowable common costs shall be allocated to the Liberty Water affiliates
22 based on the number of regulated Liberty Water companies (17) divided by the
23 total number of companies owned or operated by APIF at the end of the test
24 year (70).
- 25 3. The Liberty Water allocation shall be further allocated to RRUI on the basis of
26 the percentage of RRUI customers of the total number of Liberty Water
27 customers. Thus, for the 2008 test year, 9.55 percent is allocated to RRUI's
28 water division and 3.15 percent is allocated to the wastewater division.

26 Using the methodology described above, the total APT cost to be allocated to RRUI's water
27 division in the test year is \$33,744, and to the wastewater division is \$11,130. We believe this level
28 of common costs represents a reasonable amount in this proceeding based the size of the Company

and the benefits provided.

	Pool Amount	Liberty Water Allocation Factor (17/70)	Liberty Water
Audit	\$949,550	24.29%	\$230,646
Tax	242,844	24.29%	58,987
Legal	253,766	24.29%	61,640
License Fees, Permits	8,497	24.29%	2,064
Total	\$1,645,759		\$353,337

$\$353,337 \times .0955 = \$33,744$ allocated to RRUI's water division.

$\$353,337 \times .0315 = \$11,130$ allocated to RRUI's wastewater division.

We do not take issue with the Liberty Water shared services model as an appropriate means of operating Arizona utilities. All the utilities in Arizona that provide services under a shared services model have unique characteristics and we review each model based on the individual circumstances of each case. In this case, we have not allowed the recovery of all of the common APT costs because the Company has not met its burden to demonstrate that all of these expenses should be borne by RRUI ratepayers instead of APIF shareholders.

C. Rate Case Expense

1. RRUI's Position

The Company's Final Schedules include \$360,000 in rate case expense, allocated \$225,000 (62.5 percent) to the water division and \$135,000 (37.5 percent) to the wastewater division. The Company proposes an annual rate case expense of \$75,000 for the water division and \$45,000 for the wastewater division. This is an increase from the estimated rate case expense of \$335,000 requested in the Application, which resulted in an annual expense of \$70,000 for the water division and \$41,667 for the wastewater division.

The Company asserts that the revised rate case expense more closely tracks the actual amounts incurred, including additional hearing days, transcripts and travel costs.

2. RUCO's Position

RUCO recommends a rate case expense of \$189,000 for the water division and \$93,750 for

the wastewater division, for a total rate case expense of \$282,750.⁶³ RUCO recommends amortizing this amount over three years, resulting in an annual rate case expense of \$63,000 for the water division and \$31,250 for the wastewater division.

RUCO arrived at its recommended rate case expense by reducing the Company's original rate case expense for the water division by 10 percent (i.e., \$210,000 - \$21,000), and reducing the Company's original request for the wastewater division by 25 percent (i.e. \$125,000-\$31,250). RUCO believes that the Company's final position for rate case expense of \$360,000 is unreasonable, and argues that the standard for recovery is "reasonable expense," not "actual expense" or the amount of expense that it takes this Company to prepare its case. RUCO states it is "at a loss to understand how ratepayers benefit by paying for a Company's rate case expense which has at its core the sole purpose of raising ratepayer's rates."⁶⁴

3. Staff's Position

Staff recommends rejecting the Company request for additional rate case expense, and continues to recommend an annual rate case expense of \$70,000 for the water division and \$41,667 for the wastewater division.

Staff believes that the Company's original estimate of rate case expense is reasonable, and argues that the ratepayers should not bear the entire burden of rate case expense when the most contested issues involved the continued attempt by the Company to recover expenses which in Staff's view should be borne by shareholders.⁶⁵

4. Resolution

We find that the Company's original annual rate case expense of \$70,000 for the water division and \$41,667 for the wastewater division are reasonable given the size of the RRUI utility, with a combined customer count of 8,800. Besides the goal of reducing the rate case expense, RUCO does not provide an explanation for its final position. We recognize that RRUI has incurred additional rate case expenses related to this Application, but find that it is fair and reasonable that shareholders bear a portion of the rate case expense.

⁶³ RUCO Closing Brief at 11.

⁶⁴ RUCO Closing Brief at 12.

⁶⁵ Staff Reply Brief at 7.

D. Test Year Operating Income Summary

Based on the discussion of revenues and operating expenses set forth above, we find RRUI's adjusted test year revenues to be \$1,847,255, for the water division and its total water division adjusted test year expenses to be \$1,930,741, which results in test year adjusted operating loss of \$83,485 for a negative return of 1.07 percent on the test year FVRB of \$7,808,822.

For the wastewater division we find RRUI's adjusted test year revenues to be \$1,829,976, and its adjusted test year expenses to be \$1,342,278, resulting in test year adjusted operating income of \$487,698, a 15.11 percent rate of return on the test year FVRB of \$3,226,898.

Water Division:

Total Test Year Revenue	\$1,847,256
Operating Exp (Except Taxes)	1,944,487
Property Taxes	88,210
Income Taxes	(101,956)
Total Operating Expenses	<u>1,930,741</u>
Operating Loss	(\$83,485)

Wastewater Division:

Total Test Year Revenue	\$1,829,976
Operating Exp (Except Taxes)	971,751
Property Taxes	87,068
Income Taxes	283,459
Total Operating Expenses	<u>1,342,278</u>
Operating Income	\$487,698

IV. COST OF CAPITAL

RRUI and Staff recommend using the Company's actual capital structure of 100 percent equity. RUCO recommends using a hypothetical capital structure of 60 percent equity and 40 percent debt.

RRUI proposed a cost of equity of 11.7 percent, and a cost of capital of 11.7 percent.

Staff recommends a cost of equity of 9.2 percent and a cost of capital and recommended rate of return of 9.2 percent.

RUCO recommends a cost of equity of 9.0 percent, cost of debt of 6.26 percent, and a weighted cost of capital of 7.9 percent.⁶⁶

⁶⁶ RUCO's Final Schedules, WAR-1.

1 **A. RRUI's Position**

2 The Company's witness, Mr. Bourassa, utilized the Discounted Cash Flow Model ("DCF")
 3 and the Capital Asset Pricing Model ("CAPM") to determine the Company's Cost of Equity. Because
 4 the Company has no debt, its proposed cost of equity is its proposed cost of capital. Mr. Bourassa
 5 adjusted the cost of equity produced by the DCF and CAPM downward by 100 basis points to
 6 account for the absence of debt in the Company's capital structure. He then adjusted the cost of
 7 equity upward by 50 basis points to account for the Company's small size relative to the proxy
 8 companies, RRUI's lack of investment liquidity (i.e., an equity investment in the Company cannot be
 9 sold quickly on a stock exchange); and the additional risk that Mr. Bourassa alleges results from the
 10 particular rate-making methods employed in Arizona.

11 RRUI argues that the Constitution guarantees a utility an opportunity to earn the reasonable
 12 cost of conducting their business, including a return on its property devoted to public service that is
 13 sufficient to (1) allow the utility to attract capital on reasonable terms; (2) maintain the utility's
 14 financial integrity; and (3) allow the utility an opportunity to earn a return that is commensurate with
 15 the returns earned by enterprises with comparable risks. The Company asserts that the criteria
 16 established by the United States Supreme Court require the use of comparable companies, i.e.,
 17 companies that would be viewed by investors as having similar risk. The Company cites the United
 18 States Supreme Court's *Bluefield* decision:

19 A public utility is entitled to such rates as will permit it to earn a return
 20 on the value of the property which it employs for the convenience of the
 21 public equal to that generally being made at the same time and in the
 22 same general part of the country on investments in other business
 23 undertakings which are attended by corresponding risks and
 24 uncertainties; but it has no constitutional right to profits such as are
 realized or anticipated in highly profitable enterprises or speculative
 ventures. The returns should be reasonably sufficient to ensure
 confidence in the financial soundness of the utility and should be
 adequate under efficient and economical management, to maintain and
 support its credit and enable it to raise the money necessary for the proper
 discharge of its public duties.⁶⁷

25 In addition, RRUI cites the Supreme Court decision in *Hope Natural Gas*:

26 [T]he investor interest has a legitimate concern with the financial
 27 integrity of the company whose rates are regulated. From the investor or
 company point of view it is important that there be enough revenue not

28 ⁶⁷ *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. at 692-93 (1923).

only for operating expenses but also for capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises with corresponding risks. The return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.⁶⁸

The Company claims it is well-established that investment risk increases as the size of the firm diminishes and that RRUI's lack of liquidity increases investment risk.⁶⁹ The Company notes that the sizes of the water companies in the proxy sample group are many times greater than that of RRUI, with the result that the DCF and CAPM models understate the risk level associated with investing in RRUI. The Company argues that no rational investor would regard RRUI as having the same level of risk as Aqua American or Connecticut Water, and RRUI can not effectively compete with those firms to attract capital on reasonable terms.⁷⁰

In addition, the Company argues the Commission must consider the specific risks affecting the utility's operations and earnings, including "risks created by the regulatory standards and requirements to which the utility is subject."⁷¹ The Company cites the United Supreme Court decision in *Duquesne Light*:

[T]he impact of certain rates can only be evaluated in the context of the system under which they are imposed. One of the elements always relevant to setting the rate . . . is the return investors expect given the risk of the enterprise. . . . the risk a utility faces are in large part defined by the rate methodology because utilities are virtually always public monopolies dealing in an essential service, and so relatively immune to the usual market risks.⁷²

The Company asserts that regulation can increase business risk if it doesn't provide adequate returns or provide an opportunity for the utility to earn a fair return.⁷³ The Company in this case, proposes an upward adjustment to the cost of equity of 50 basis points to account for its small size, lack of investment liquidity and additional risk associated with Arizona's particular regulatory system. In this respect, the Company supports RUCO's proposed upward adjustment of 110 basis points, and argues that Staff's failure to account for RRUI's small size and lack of liquidity is one-sided and

⁶⁸ *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 603 (1944).

⁶⁹ Tr. at 1079-80.

⁷⁰ RRUI Closing Brief at 44, *citing*, Ex A-5, Buorassa COC Direct at 16-22; Ex A- 7 Bourassa COC Rebuttal at 11-14.

⁷¹ RRUI Closing Brief at 44.

⁷² *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314-15. (1989).

⁷³ RRUI Closing Brief at 44, *citing* Roger A. Morin, New Regulatory Finance 38-39 (Public Utility Reports, Inc. 2006) ("*Morin*").

1 arbitrary and violates the *Bluefield/Hope* attraction of capital and comparable earnings standard.

2 The Company argues that Staff's and RUCO's recommended cost of equity are too low and
3 fail to reflect current market risk or the Company's individual risk profile. The Company notes that
4 the average beta of the proxy group has increased since RRUI's last rate case, which means that
5 stocks have become more risky relative to the market. The Company argues that despite the
6 indications of higher risk, Staff's proposed return is only 50 basis points higher than the return
7 authorized in its 2004 rate case (Decision No. 67279), and RUCO's effective return on equity is
8 nearly 200 basis points lower. The Company argues this demonstrates that neither Staff's nor
9 RUCO's proposed cost of capital meet the *Bluefield/Hope* standard. The Company believes its
10 position is further supported by *Value Line's* projections, which the Company believes indicates
11 current returns higher than Staff's and RUCO's recommendations, as well as increasing returns in
12 2012.⁷⁴

13 The Company notes further, that the proxy group utilities operate in jurisdictions such as
14 California and Pennsylvania that use projected or partially projected test years, and authorize
15 surcharges and other cost recovery mechanisms which recover increases in costs outside of a general
16 rate case. The Company argues these practices lower the risk of the proxy group.⁷⁵

17 The Company argues that Staff double-counts historic growth rates in estimating future
18 dividend growth rates, which in turn causes Staff's DCF estimate to be understated.⁷⁶ The Company
19 argues that Staff's methodology, which averages historic growth rates, is illogical and substantially
20 depresses the results of the DCF model. The Company asserts that analysts have already considered
21 relevant historical information in their future growth projections and a stock's current price reflects
22 all known historic information, so any further recognition of the past, double-counts what has already
23 occurred.

24 The Company also argues that Staff's adjustment for financial risk is overstated because Staff
25 applied the Hamada formula by using the book value of the sample utilities' equity rather than the
26 market value and assumed the average beta of the sample water utilities can be applied directly to

27 ⁷⁴ RRUI Closing Brief at 48.

28 ⁷⁵ Ex A-7 at 7.

⁷⁶ RRUI Closing Brief at 49.

1 RRUI, even though RRUI is smaller than the sample group. The Company alleges that Staff's cost of
 2 equity estimate would increase from 9.2 percent to 9.7 percent if market values were used in the
 3 Hamada formula rather than book value.⁷⁷

4 The Company argues that RUCO's water industry group is flawed because RUCO eliminated
 5 Connecticut Water Services, Middlesex Water Company and SJW Corporation from the typical
 6 proxy group utilized by the Company and Staff, and substituted Southwest Water Company. The
 7 Company argues that Southwest Water is not comparable to RRUI or to the publically traded water
 8 utilities in the proxy group as less than 50 percent of Southwest Water's revenues are derived from
 9 regulated activities and because Southwest Water is a financially distressed utility. RRUI also argues
 10 that RUCO's use of 10 gas distribution companies in the sample group is not comparable to RRUI
 11 and should not be used. Furthermore, the Company asserts the water industry sample has
 12 significantly more risk (average beta 0.83) than the gas industry sample (average beta of 0.67).

13 The Company argues that RUCO's CAPM estimates are unreasonable and should not be used
 14 because they produce an unreasonable result (6.10 percent), which is below the current cost of Baa
 15 investment grade bonds (6.35 percent).⁷⁸

16 The Company also criticizes RUCO's use of a geometric mean to estimate the risk premium
 17 in the CAPM and because it ignores current market risk. The Company argues that the Commission
 18 typically uses the arithmetic average as Staff and the Company did in this case.⁷⁹ The Company also
 19 criticizes RUCO's use of a 5-year U.S. Treasury bond as the risk-free rate, when it claims that the
 20 proper risk-free rate should be a 30-year U.S. Treasury bond.⁸⁰

21 RRUI argues that RUCO's proposed hypothetical capital structure is unfair and conflicts with
 22 prior Commission Decisions. The Company alleges that RUCO's hypothetical capital structure is
 23 intended to lower RRUI's rate of return and produce lower rates. The Company asserts that, with one
 24 exception, the Commission has never approved this sort of "results-driven" approach. The Company
 25 asserts that the Commission rejected RUCO's recommendations in the previous Black Mountain rate

27 ⁷⁷ RRUI Closing brief at 53.

⁷⁸ RRUI Closing Brief at 59.

⁷⁹ RRUI Closing Brief at 60.

28 ⁸⁰ RRUI Closing Brief at 62, *citing Morin* at 151-52.

1 case, and used the Hamada formula to reflect financial risk.⁸¹ The Company asserts that to the extent
2 an adjustment for financial risk is found necessary, the Commission should adhere to its precedent
3 and employ the Hamada formula. The Company argues that RUCO has provided no legitimate basis
4 to depart from the “generally accepted regulatory means” for accounting for differences in financial
5 risk.

6 The Company also objects to RUCO’s proposed interest rate on its hypothetical debt of 6.26
7 percent, because there is no evidence that RRUI could actually finance 40 percent of its plant at such
8 rate. RRUI charges that RUCO’s recommended rate of return of 7.9 percent is unreasonable and
9 confiscatory.

10 **B. RUCO’s Position**

11 RUCO recommends that the Commission adopt a hypothetical capital structure of 60 percent
12 equity and 40 percent debt. RUCO believes its proposal provides for a balanced capital structure that
13 is more prudent and more appropriate than the actual capital structure comprised of 100 percent
14 equity. RUCO argues that the Company’s choice to utilize higher cost equity over debt deprives
15 ratepayers of the benefits associated with debt in the capital structure, such as the tax shield that debt
16 provides as the interest expense lowers the Company’s tax liability. RUCO asserts that a
17 hypothetical capital structure that emulates the industry provides balance between the interests of
18 ratepayers and the interests of the shareholders.

19 RUCO argues that its proposed 60 percent equity, 40 percent debt capital structure is not
20 arbitrary, as the water companies in RUCO’s proxy group had an average of 47.8 percent debt and
21 51.7 percent equity, and the local gas distribution company’s in the proxy group had an average
22 capital structure of 45.9 percent debt and 53.4 percent equity. RUCO states that utilizing gas
23 distribution companies in its proxy group is reasonable because they have similar operating
24 characteristics and risk as RRUI.

25 RUCO asserts that using a hypothetical capital structure is preferable to the Hamada
26 methodology for adjusting the cost of equity to reflect the lower risk associated with the absence of
27 debt because the Hamada adjustment relates to the CAPM and might not be equally applied to the

28 ⁸¹ Ex R-1 at 20.

1 DCF estimate. RUCO points out that in the Gold Canyon Sewer rate case the Commission adopted
2 RUCO's hypothetical capital structure over the Hamada methodology.⁸² RUCO notes that Gold
3 Canyon, like RRUI, is an affiliate of Liberty Water, and had a 100 percent equity capital structure.
4 RUCO believes the Commission's reasoning in the Gold Canyon case applies equally in the current
5 case.

6 RUCO argues that the Company's proposed cost of equity of 11.70 percent is too high given
7 the current environment of low inflation and low interest rates in which the Company operates.
8 RUCO believes that its recommendation of a 9.0 cost of equity is supported by the Federal Reserve's
9 recent announcements to hold interest rates steady and *Value Line's* projections of interest rate
10 costs.⁸³

11 RUCO asserts that its use of the geometric mean comports with industry standards and states
12 that it is no wonder utilities don't like the geometric mean because when there is volatility, the
13 geometric mean will be lower than the arithmetic mean. RUCO argues that its resultant calculation of
14 the risk premium comports with recent empirical research.⁸⁴

15 **C. Staff's Position**

16 Staff uses the DCF model and the CAPM, and states that its cost of equity recommendation is
17 based on market-based financial models that are accepted by the Commission. Staff states that its
18 inputs utilize both historical and forecasted economic information, which Staff believes a typical
19 investor can reasonably be expected to consider in determining the expected rate of return. Staff
20 asserts that the models it employs are widely accepted in the financial industry and by this
21 Commission in setting just and reasonable rates of return.

22 Staff used two DCF estimates, the constant growth DCF model (9.4 percent) and the multi-
23 stage DCF model (10.3 percent); and two CAPM estimates, one using an historical market risk
24 premium (8.6 percent) and one using a current market risk premium (12.6 percent). Staff first
25 averaged the DCF results (9.9 percent) and then calculated an average for the CAPM results (10.6
26 percent). Staff then took the average of both models (10.3 percent) and subtracted 110 basis points

27 ⁸² Decision No. 70624 (November 19, 2008).

28 ⁸³ Ex RUCO-18 at 4.

⁸⁴ RUCO Reply Brief at 14.

1 (1.1 percent) for financial risk by using the Hamada method, to arrive at a cost of equity of 9.2
2 percent. For the constant growth DCF, Staff calculated the growth factor by averaging the results of
3 historical and forecasted earnings per share ("EPS"), dividends per share ("DPS"), and sustainable
4 growth. Staff asserts that it utilized a balanced methodology that gives equal weight to historical and
5 projected EPS, DPS and sustainable growth.

6 Staff argues that the Company's selectively chosen inputs in its models results in an inflated
7 cost of equity. Staff asserts that generally, analysts should not eliminate or modify inputs in the cost
8 of equity estimate because they produce unfavorable outputs, skew the results and create an
9 unbalanced cost of equity. Staff criticizes the Company's approach of using two constant growth
10 DCF models — Past and Future Growth and Future Only Growth — instead of a multi-stage and
11 constant growth model like Staff. Staff states that half of the Past and Future Growth estimate and
12 the entire Future Growth estimate rely on analyst projections, which Staff believes does not give
13 appropriate weight to historical data. Staff's witness, Juan Manrique, testified that analyst forecasts
14 are overly optimistic.⁸⁵ Staff argues that giving equal weight to historical and prospective looking
15 data is appropriate for calculating the growth factor in the DCF model. Staff also believes that the
16 Company's use of five years of historical data is too limited to capture a full business cycle and is
17 susceptible to significant variances if there is a single high or low point. Staff utilized a ten year
18 period which it believes captures a better picture of the economic environment.

19 Because RRUI is not a publically traded company, Staff calculated the average of the *Value*
20 *Line* betas of the sample water utilities as a proxy for RRUI's beta in its CAPM calculation. Staff
21 argues that because RRUI is not an unassociated small company, but the subsidiary of a much larger
22 entity, it has access to resources and capital markets that most small companies do not, and thus no
23 other adjustment is necessary.

24 Staff states that the Commission has recognized that the Hamada equation, as used by Staff, is
25 an appropriate method to address a company's unbalanced capital structure. Staff asserts that the
26 Hamada equation uses quantifiable data and uses a company's actual capital structure. Staff states
27 further, that while the Company also used the Hamada method to calculate a downward adjustment

28 ⁸⁵ Ex S-13, at 35-36.

1 for financial risk, it criticized Staff's use of book value of equity, as opposed to market values in their
2 calculations. Staff claims that Staff's method has been consistently employed by Staff in numerous
3 rate cases and adopted by the Commission in many decisions.

4 Staff urges the Commission to reject the Company's argument that it is susceptible to
5 additional "firm-specific risk." Staff claims that contrary to the Company's assertions, Staff does not
6 ignore firm-specific risks, but rather has long taken the view that "firm-specific risk" is a non-market
7 risk that can be eliminated by holding a diverse portfolio, and thus should not be reflected in the cost
8 of equity. Staff asserts that the Company cannot precisely quantify the effect of "small firm risk" on
9 the Company. Staff finds it interesting that the Company argues that one of the benefits of a shared
10 services model is the access to capital markets, and associated with affiliation with a large firm, yet
11 argues for a small firm risk premium. Staff states that the Commission has expressly rejected the
12 "small firm risk premium" and Staff recommends that the Commission continue this pattern.

13 Staff notes that the *Hope* decision cited by the Company also requires that rate regulation take
14 account of both the consumer and investor interests.⁸⁶ Staff argues that in setting a fair rate of return
15 that attracts capital and provides returns commensurate with other investments with corresponding
16 risk, the Commission must consider the impact on the public interest.

17 **D. Resolution**

18 At open meeting held December 14 and 15, 2010, the Company committed to file a financing
19 application with the Commission in 2011 to infuse 20 percent debt into the Company's capital
20 structure with an actual cost of debt of 5.7 percent. Based on that commitment, the Company has
21 offered to use a hypothetical capital structure in this case of 20 percent debt and 80 percent equity,
22 with a cost of debt of 5.7 percent. The parties also have agreed to use a 9.5 percent return on equity
23 in this case. We agree with a proposed hypothetical capital structure of 20 percent debt and 80
24 percent equity with a 9.5 percent return on equity and a 5.7 percent cost of debt. Applying the 9.5
25 percent cost of equity and 5.7 percent cost of debt to the hypothetical capital structure results in an
26 overall weighted cost of capital for the Company of 8.74.

27 The Commission generally does not find a small firm risk premium or an adjustment to the

28 ⁸⁶ 320 U.S. 511, 603.

cost of capital to be appropriate. We do not find any unique circumstances about this case to warrant such adjustment to the cost of capital. The Company's claim that RRUI is riskier than the larger entities used in the proxy sample fails to consider that RRUI is part of the much larger APIF family of companies. The Company did not offer objective evidence that RRUI is entitled to an upward adjustment of its authorized rate of return in order to attract capital at reasonable rates.

The *Hope* and *Bluefield* decisions provide that the return determined by the Commission must be equivalent to an investment with similar risk made at generally the same time, and should be sufficient under efficient management to enable the company to discharge its duties. The *Bluefield* court also found "[w]hat annual rate will constitute just compensation depends on many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts."⁸⁷ The Commission has broad discretion in how it meets its obligation to set fair and reasonable rates.⁸⁸ The Commission must consider the entire public interest which includes the concerns of ratepayers and shareholders. Using this standard, we find that a cost of capital of 8.74 percent under the totality of circumstances in this case, represents a fair balance of these interests and will allow the Company to attract capital and continue to provide adequate service to RRUI ratepayers.

V. Revenue Requirement

Based on our findings herein, we determine that RRUI's water division is entitled to a gross revenue increase of \$1,261,007.

FVRB	\$7,808,822
Adjusted Operating Income	(\$83,485)
Required Rate of Return	8.74%
Required Operating Income	\$682,491
Operating Income Deficiency	\$765,976
Gross Rev Conv Factor	1.6463
Gross Revenue Increase	\$1,261,007
Adjusted test year Revenue	\$1,847,256
Approved Annual Revenue	\$3,108,263
Percentage Revenue Increase	68.26%

Based on our findings herein, we determine that RRUI's wastewater division should receive a

⁸⁷ *Bluefield* at 262 U.S. at 692.

⁸⁸ *Scates et. al v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 534 (Ct. App. 1978).

gross revenue decrease of \$340,355.

FVRB	\$3,226,899
Adjusted Operating Income	\$487,698
Required Rate of Return	8.74%
Required Operating Income	\$282,031
Operating Income Deficiency (Excess)	(\$205,667)
Gross Rev Conv. Factor	1.6549
Gross Revenue Increase (Decrease)	(\$340,455)
Adjusted Test Year Revenue	\$1,829,976
Approved Annual Revenue	\$1,489,621
Percentage Decrease	-18.60%

VI. RATE DESIGN/HOOK-UP FEES/OTHER ISSUES

A. Rate Design – Wastewater Division

For the wastewater division, all parties recommend the same rate design and spread their respective recommended revenue decreases evenly across all customer classes.

A summary of the current wastewater rates and the parties' recommendations follows:

Monthly Minimum Charge:	Present	<u>Proposed Rates</u>		
	<u>Rates</u>	<u>Company</u>	<u>RUCO</u>	<u>Staff</u>
Meter Size (all Classes)				
5/8" Meter	\$ 56.36	\$ 52.10	\$ 40.84	\$ 47.03
3/4" Meter	64.27	59.42	46.57	53.63
1" Meter	79.40	73.41	57.53	66.26
1-1/2" Meter	117.24	108.39	84.95	97.83
2" Meter	162.62	150.34	117.83	135.70
3" Meter	283.30	261.91	205.27	236.40
4" Meter	419.91	388.21	304.25	350.40
6" Meter	797.96	737.71	578.17	665.86
8" Meter	1,252.11	1,157.58		1,044.93
10" Meter	1,781.93	1,647.39		1,487.08
12" Meter	3,295.77	3,046.94		2,411.50

Commodity Rates – All Meter Sizes:

(Commercial and Multi-Tenant Only)

0 to 7,000 gallons	--	--	--	--
Over 7,000 gallons	\$ 5.71	\$ 5.28	\$ 4.14	\$ 4.59

Based on our approved revenue level of \$1,385,019, we approve the following rates for RRUI's wastewater division, which spreads the approved decrease evenly among the rate classes.

Monthly Minimum Charge:

Approved Rates

Meter Size (all Classes)

5/8" Meter	\$45.88
3/4" Meter	52.88
1" Meter	64.64
1-1/2" Meter	95.44
2" Meter	132.38

3" Meter	230.62
4" Meter	341.83
6" Meter	649.58
8" Meter	944.45
10" Meter	1,415.24
12" Meter	2,012.57

Commodity Rates – All Meter Sizes:
(Commercial and Multi-Tenant Only)
Over 7,000 gallons

\$4.67

Neither Staff nor RUCO object to RRUI's proposed service line and meter installation charges or its proposed service charges. We approve the Service Charges and Service Line and Meter Installation Charges as follows:

Service Charges:

Establishment	\$15.00
Establishment (After Hours)	\$25.00
Reconnection (Delinquent)	\$15.00
Reconnection (Delinquent after hours)	\$25.00
Deposit	Per Rule*
Deposit Interest	Per Rule*
Re-Establishment (within 12 months)	Per Rule**
NSF Check	\$15.00
Deferred Payment ***	1.5% / mo
Moving Meter at customer request	At Cost
Service calls- per hour/after hours	\$40.00

* Per Commission Rules (R14-2-403.B)

** Months off system times the minimum (R14-2-403.D)

*** Per Commission Rules (R14-2-409.G)

Service Line and Meter Installation Charges:

Service Line Size	
4" Meter	At Cost
6" Meter	At Cost
8" Meter	At Cost
10" Meter	At Cost
12" Meter	At Cost

Under the rates approved herein, a residential wastewater customer with a 5/8 inch water meter will see a monthly decrease of \$10.48, or 18.59 percent, from \$56.36 to \$45.88.

B. Rate Design – Water Division

The Company's water division currently has a three tier inverted rate design for residential users and a two tier rate design for the larger meters.

A summary of the Company's current water rates and the parties' recommended rates follows:

Present

Proposed Rates

Monthly Usage Charge

Rates	Company⁸⁹	RUCO⁹⁰	Staff⁹¹
\$ 6.45	\$ 13.11	\$ 9.53	\$ 11.20
9.65	19.67	14.26	26.80
17.10	32.78	25.26	28.00
34.70	65.55	51.25	56.00
54.00	104.88	79.76	89.60
105.40	209.76	155.68	179.20
173.50	327.75	256.26	280.00
321.25	655.50	474.48	560.00
514.00	1,048.80		896.00
745.30	1,507.65		1,288.00
1,395.00	1,966.50		2,408.00

Fire Lines

Up to 8"	6.48	13.00	13.77	Per Rule *
10"	7.45	15.00		Per Rule *
12"	14.00	30.00		Per Rule *

Commodity Rates – All Classes
(per 1,000 gallons)

5/8" x 3/4" meter				
From 0 to 4,000 gallons	\$1.44	\$2.75	\$2.04	
From 4,001 to 10,000 gallons	.70	3.45	2.56	
Over 10,000 gallons	1.90	3.85	2.91	
From 0 to 3,000 gallons				1.68
From 3,001 to 9,000 gallons				3.08
Over 9,000 gallons				3.83
3/4" Meter				
From 0 to 6,000 gallons	1.70	3.45	2.56	3.08
Over 6,000 gallons	1.90	3.85	2.91	3.83
1" Meter				
From 0 to 15,000 gallons	1.70	3.45	2.56	3.08
Over 15,000 gallons	1.90	3.85	2.91	3.83
1-1/2" Meter				
From 0 to 20,000 gallons	1.70	3.45	2.56	3.08
Over 20,000 gallons	1.90	3.85	2.91	3.83
2" Meter				
From 0 to 57,000 gallons	1.70		2.56	3.08
Over 57,000 gallons	1.90		2.91	3.83
From 0 to 50,000 gallons		3.45		
Over 50,000 gallons		3.85		
3" Meter				
From 0 to 57,000 gallons	1.70		2.56	3.08
Over 57,000 gallons	1.90		2.91	3.83

⁸⁹ RRUI Final Schedules H-3.⁹⁰ RUCO Final Schedules at TJC-RD1.⁹¹ Staff Final Rate Design Schedules GWB-1.

1	From 0 to 80,000 gallons	3.45		
2	Over 80,000 gallons	3.85		
3	4" Meter			
4	From 0 to 57,000 gallons	1.70	2.56	3.08
5	Over 57,000 gallons	1.90	2.91	3.83
6	From 0 to 160,000 gallons	3.45		
7	Over 160,000 gallons	3.85		
8	6" Meter			
9	From 0 to 125,000 gallons	1.70	2.56	3.08
10	Over 125,000 gallons	1.90	2.91	3.83
11	From 0 to 250,000 gallons	3.45		
12	Over 250,000 gallons	3.85		
13	8" Meter			
14	From 0 to 125,000 gallons	1.70		3.08
15	Over 125,000 gallons	1.90		3.83
16	From 0 to 500,000 gallons	3.45		
17	Over 500,000 gallons	3.85		
18	10" Meter			
19	From 0 to 125,000 gallons	1.70		3.08
20	Over 125,000 gallons	1.90		3.83
21	From 0 to 800,000 gallons	3.45		
22	Over 800,000 gallons	3.85		
23	12" Meter			
24	From 0 to 125,000 gallons	1.70		3.08
25	Over 125,000 gallons	1.90		3.83
26	From 0 to 1,150,000 gallons	3.45		
27	Over 1,150,000 gallons	3.85		

* 1% of Monthly Minimum for a Comparable Size Meter Connection, but no less than \$5.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct for the primary water service line.

1. RRUI's Position

The Company charges that Staff's proposed design results in larger users subsidizing smaller users and shifts revenue away from the fixed monthly charge. The Company claims that despite recommending an overall rate increase of 57 percent, Staff increases the first tier rate by only \$0.06, or 4 percent, for the 5/8 inch customers. The Company argues that minimizing the increase on the residential customers is achieved by passing along more of the revenue requirement to the commercial and industrial customers, which is illustrated by the 5/8 inch residential customers

1 experiencing a 49 percent increase while the commercial and industrial customers would see
2 increases between 57 and 70 percent under Staff's design.⁹²

3 The Company also claims that under Staff's proposed design, 28.8 percent of the revenue
4 would come from the fixed monthly charge, which is less than the typical 30 to 40 percent, and is
5 further indication of commercial customers subsidizing the residential users. The Company asserts
6 the revenue shift is demonstrated by the fact that under current rates, approximately 34.6 percent of
7 revenues are recovered from the monthly minimum and the first tier, while under Staff's proposed
8 rate design, the percentage drops to about 33.2 percent. RRUI argues that if it is Staff's concern that
9 non-discretionary water levels are not overpriced, the Company's proposed low income tariff is
10 designed to ensure that those who cannot afford water can pay for it.

11 **2. RUCO's Position**

12 RUCO proposes an inverted tier design with the same break over points as the Company's
13 current rates. RUCO believes that its rate design spreads the increase in a fair and balanced manner.⁹³

14 **3. Staff's Position**

15 Staff recommended lowering the first tier for residential users to 3,000 gallons and
16 maintaining the existing break over points for the larger meters. Staff believes that its recommended
17 rate design promotes efficient water use and provides an economic benefit to customers who limit
18 consumption.

19 Staff states that in general, Staff designs water rates so that 30 to 40 percent of the revenues
20 are derived from the fixed monthly charge. In this case, Staff's recommended rate design derives
21 approximately 28.6 percent of the revenue from the fixed charge. Staff states that it is steadfast in
22 recommending a rate design that seeks to maintain the affordability of non-discretionary usage and to
23 encourage efficient use of water through appropriate price signals.⁹⁴

24 **4. Resolution**

25 Based on the revenue level we authorize in this case, we approve the following rates and
26 charges for the RRUI's water division:

27 ⁹² RRUI Closing Brief at 72.

28 ⁹³ RUCO Closing Brief at 18.

⁹⁴ Staff's Initial Brief at 11.

Monthly Usage Charges:

5/8" x 3/4" Meter	\$ 10.98
3/4" Meter	16.47
1" Meter	27.45
1-1/2" Meter	54.90
2" Meter	87.84
3" Meter	175.68
4" Meter	274.50
6" Meter	549.00
8" Meter	878.40
10" Meter	1,262.70
12" Meter	2,360.70

Fire Lines:

Up to 8"	Per Rule *
10"	Per Rule *
12"	Per Rule *

Commodity Rates – All Classes:

(per 1,000 gallons)

5/8" x 3/4" Meter

From 0 to 3,000 gallons	1.59
From 3,001 to 9,000 gallons	2.92
Over 9,000 gallons	3.64

3/4" Meter

From 0 to 6,000 gallons	2.92
Over 6,000 gallons	3.64

1" Meter

From 0 to 15,000 gallons	2.92
Over 15,000 gallons	3.64

1-1/2" Meter

From 0 to 20,000 gallons	2.92
Over 20,000 gallons	3.64

2" Meter

From 0 to 57,000 gallons	2.92
Over 57,000 gallons	3.64

3" Meter

From 0 to 57,000 gallons	2.92
Over 57,000 gallons	3.64

4" Meter

From 0 to 57,000 gallons	2.92
--------------------------	------

1	Over 57,0000 gallons	3.64
2	6" Meter	
3	From 0 to 125,000 gallons	2.92
4	Over 125,0000 gallons	3.64
5	8" Meter	
6	From 0 to 125,000 gallons	2.92
7	Over 125,0000 gallons	3.64
8	10" Meter	
9	From 0 to 125,000 gallons	2.92
10	Over 125,0000 gallons	3.64
11	12" Meter	
12	From 0 to 125,000 gallons	2.92
13	Over 125,0000 gallons	3.64

* 1% of Monthly Minimum for a Comparable Size Meter Connection, but no less than \$5.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct for the primary water service line.

Service Charges:

Establishment	\$15.00
Establishment (After Hours)	\$25.00
Reconnection (Delinquent)	\$15.00
Reconnection (Delinquent after hours)	\$25.00
Meter Test (If Correct)	\$15.00
Deposit	Per Rule*
Deposit Interest	Per Rule*
Re-Establishment (within 12 months)	Per Rule**
NSF Check	\$15.00
Meter Re-Read (If Correct)	\$20.00
Late Payment Penalty	1.5% / mo.
Deferred Payment ***	1.5% / mo
Moving Meter at customer request	At Cost
Service calls- per hour/after hours	\$40.00

* Per Commission Rules (R14-2-403.B)

** Months off system times the minimum (R14-2-403.D)

*** Per Commission Rules (R14-2-409.G)

Service Line and Meter Installation Charges:

(Refundable Pursuant to A.A.C R14-2-405)	<u>Service Line</u>	<u>Meter</u>	<u>Total</u>
5/8" x 3/4" Meter	At Cost	At Cost	At Cost
3/4" Meter	At Cost	At Cost	At Cost
1" Meter	At Cost	At Cost	At Cost
1-1/2" Meter	At Cost	At Cost	At Cost
2" Meter	At Cost	At Cost	At Cost
3" Meter	At Cost	At Cost	At Cost
4" Meter	At Cost	At Cost	At Cost
6" Meter	At Cost	At Cost	At Cost

8" Meter	At Cost	At Cost	At Cost
10" Meter	At Cost	At Cost	At Cost
12" Meter	At Cost	At Cost	At Cost

Under the rates approved herein, the average residential water customer with a 5/8-inch meter and monthly usage of 8,548 gallons would see an increase of \$12.01, or 60.2 percent, from \$19.94 to \$31.95. The median monthly usage for the 5/8-inch meter is 7,000 gallons, and the median customer would see a monthly increase of \$10.12, or 58.5 percent, from \$17.31 to \$27.43.

We find that the rate design we approve is fair and equitable and reasonably calculated to generate the approved revenue level.

C. Low Income Tariff

1. RRUI's Position

RRUI proposed a low income tariff for both divisions modeled after one approved by the Commission in the most recent Chaparral City Water Company rate case, which in turn was modeled after a low income tariff implemented by Golden State Water Company that serves several hundred thousand customers in California. The Company states it is the same form of low income tariff proposed in each of the pending rate cases for Liberty Water's utilities. All parties generally support the low-income tariff, although Staff and the Company debated a few details.

Pursuant to the proposed low income tariff, qualifying residential participants would receive a 15 percent discount applied to the regular filed tariff. To qualify: 1) the bill must be in the name of the participant and the address must be a primary address, or the participant must be a tenant receiving water service by a sub-metered system in a mobile home park; 2) the participant may not be a dependent on another person's tax return; 3) the applicant must reapply each time he or she moves; 4) the participant must renew every two years, or sooner if requested; 5) the participant must notify RRUI within 30 days if he or she becomes ineligible; and 6) the gross annual income of all persons living in the household cannot exceed the stated income levels. The initial qualifying income levels proposed are as follows:

No. of Persons in Household	Total Gross Annual Income
1	\$10,830
2	14,570

3	18,310
4	22,050
5	25,790
6	29,530

For each additional person residing in the household, add \$3,740.

Under RRUI's proposal, a customer would sign up for the program by completing an application and submitting proof of income.⁹⁵ The Company would update its gross annual household income limits annually as the federal poverty guidelines are published. The Company proposed to keep track of the discounts given to participants, plus a 10 percent fee for administration and carrying costs, which would then be recovered from non-participants by means of a commodity surcharge. The Company states it would maintain a balancing account to keep track of program costs and the collections from non-participants. The surcharge would be computed annually based on the prior year costs and collections.⁹⁶ The surcharge would be identified on the bill as a separate charge.

2. Staff's Position

Staff supports the low income tariff, with several modifications. Staff recommends that the eligibility standards be equal to 150 percent of the federal poverty level, instead of 100 percent as the Company initially proposed. While Staff agrees with the Company that participants should recertify their eligibility every two years, Staff supports an active recertification process whereby participants are required to submit an affidavit yearly attesting to their continuing eligibility. Staff recommends that participation be limited to 2,200 customers for the water division and 725 for the sewer division (approximately 30 percent).

In addition, Staff is uncertain how the Company derives its proposed 10 percent administrative fee. Staff recommends that the Company be allowed to seek recovery of direct costs (i.e. those costs directly associated with the program, and would not be incurred in the absence of the program), and that the Company account for these direct costs separately from other costs. Staff recommends that the authorized rate of return is a reasonable carrying rate, which should be applied monthly to the average of the beginning and ending balance of the cumulative unrecovered program

⁹⁵ Ex A-1, Sorensen Direct at 19.

⁹⁶ *Id.*

1 costs and included in the beginning balance for the following month.

2 Staff believes that Staff's recommended revenue and recommended limits on participation
3 will provide RRUI with sufficient cash flow to allow RRUI to carry the costs of the low income
4 program for twelve months, and that the surcharge should be implemented twelve months after
5 authorization of the program and subsequent to Commission approval of the specific surcharge
6 amount, and recalculated each twelve months thereafter.

7 Staff recommends that recovery of low income program costs via a surcharge be applicable
8 only to the residential customer class. Staff recommends that a separate balancing account be used
9 and a separate surcharge should be calculated for the water customers and sewer customers. Staff
10 recommends the surcharge equal a "dollar-and-cents" amount derived by dividing the ending balance
11 of the low income balancing account by the number of bills issued to non-participating residential
12 customers during the past twelve-month period. The ending balance in the balancing account should
13 equal the beginning balance plus discounts allowed on bills for the twelve-month tracking period,
14 plus direct program costs incurred in the twelve-month period plus carrying charges less surcharge
15 fees billed in the twelve-month tracking period.

16 **3. Resolution**

17 In its Reply Brief, RRUI agreed to all of Staff's recommended changes to the low income
18 tariff.⁹⁷

19 We agree with the parties, and will direct RRUI to file a low income tariff that comports with
20 Staff's recommendations in this case.

21 Under the wastewater rates approved herein, qualifying and participating wastewater
22 customers would be receive a discount of \$6.88. By means of example, if 500 customers participate
23 in the low income tariff, the annual discounts given would be \$41,292. Non-participating ratepayers
24 would see a surcharge of approximately \$2.42 per month (not including the allowed directs costs of
25 the program and carrying charges at a rate equivalent to the cost of capital).

26 Because every water user has a unique bill depending on usage, an estimate of the effect of
27 the low income tariff is harder to make. Under the water rates approved herein, a participating low

28 ⁹⁷ RRUI Reply Brief at 43.

1 income customer with average monthly usage of 8,548 gallons, would see a discount of \$4.79. If 500
 2 low income customers, all with average usage enrolled, the annual discounts given would be
 3 approximately \$28,755, and the non-participating residential ratepayers would see a monthly
 4 surcharge of approximately \$0.45 (before the inclusion of the allowed direct costs of the program and
 5 carrying charges).

6 **D. Hook-up Fee Tariff**

7 **1. RRUI's Position**

8 The Company has proposed a hook-up fee tariff for both the water and wastewater divisions.
 9 For its water division, the Company proposed a \$1,800 hook-up fee for a new 5/8 by 3/4 inch meter
 10 service connection. On the wastewater side, the Company proposed a \$1,800 hook-up fee per new
 11 service lateral.

12 The proposed water HUF tariff is illustrative of the proposal for both divisions, and provides
 13 in pertinent part:

14 **I. Purpose and Applicability.**

15 Purpose of the hook-up fees payable to Rio Rico Utilities, Inc. – Water
 16 Division (“the Company”) pursuant to this tariff is to equitably apportion
 17 the costs of constructing additional shared Off-Site Facilities necessary to
 18 provide water production, delivery, storage and pressure among all new
 19 service connections. These charges are applicable to all new service
 20 connections undertaken via Main Extension Agreements or requests for
 21 service not requiring a Main Extension Agreement entered into after the
 22 effective date of this tariff. The charges are one-time charges and are
 23 payable as a condition to Company’s establishment of service, as more
 24 particularly provided below.

25 **IV. Terms and Conditions**

26 (A) **Assessment of One Time Hook-Up Fee:** The Hook-Up Fee may be
 27 assessed only once per parcel, service connection, or lot within a
 28 subdivision or commercial/industrial property although a
 supplemental assessment may apply to conform to the above table
 if the intended use of a parcel is subsequently altered from that
 originally intended when the first assessment was paid.

(B) **Use of Hook-Up Fee:** Hook-Up Fees only may be used to pay for
 capital items of Off-Site Facilities or for repayment of loans obtained
 to fund the cost of installation of Off-Site Facilities. Hook-Up Fees
 shall not be used to cover repairs, maintenance, or other operating
 costs. All funds collected by the Company as Hook-Up Fees shall be
 deposited into a separate account and bear interest and shall be used
 solely for the purposes of paying for the costs of the installation of

Off-Site Facilities, including repayment of loans previously obtained for the installation of Off-Site Facilities that will benefit the water system. The Company shall not record amounts collected under this tariff as CIAC until such amounts have been expended for plant. (emphasis added)

The Company states that HUFs are a common way for regulated water and wastewater utilities to raise zero cost capital, which can be used to offset the cost of off-site plant, including water supply and wastewater treatment capacity. The Company states that it views HUF tariffs as critical to ensuring that rates remain within a reasonably acceptable range, and ensuring that developers, not the utility or ratepayers, take the "build-out risk" associated with new development.

RRUI asserts that its proposed HUFs are consistent with the NARUC definition of CIAC. The NARUC guideline states:

271. Contributions in Aid of Construction

A. This account shall include:

1. any amount or item of money, services or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition, improvement or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public. (emphasis added)⁹⁸

The Company believes that Staff opposes the HUF tariff because Staff could not tell what facilities would be built with the HUF funds and because Staff believes the Company has adequate capacity.⁹⁹ RRUI argues that not having a specific list of future plant to be built with the HUFs is not sufficient reason to deny the HUF. Furthermore, the Company disagrees with any conclusion that no additional capacity is needed.

2. RR Properties' Position

RR Properties owns property in various stages of development in RRUI's service area, and intervened in this matter to address the proposed HUF tariff. RR Properties states it takes no position on whether a HUF should be approved in this case but states that if a HUF is approved, the Commission should ensure that the benefits generally associated with a HUF are realized. RR Properties states that although it has no objection to a HUF, it wants a fair HUF that provides for certainty, prohibits collecting a HUF where off-sites have already been provided for and that

⁹⁸ See Ex A-3, Sorensen Rejoinder, ex GS RJ 2.

⁹⁹ RRUI Initial Brief at 75.

1 prohibits the Company from “double-dipping” for off-site costs by collecting extra CIAC on top of
2 the HUF.¹⁰⁰

3 RR Properties asserts that the Commission should consider the utility’s capital structure when
4 reviewing the proposed HUFs. RR Properties argues that the Company’s position that the “developer
5 should pay the entire cost of off-site facilities”¹⁰¹ is problematic because it aggravates the Company’s
6 lopsided capital structure in which CIAC comprises 67 percent, more than double the amount of
7 equity in the capital structure.¹⁰² RR Properties asserts that typically Staff recommends that CIAC
8 and AIAC constitute no more than 30 percent of a company’s total capitalization. RR Properties
9 argues that the utility investors should have some investment in new facilities since the utility also
10 benefits from new growth, not only the developer. RR Properties asserts that CIAC is not the only
11 alternative to common equity, but that debt or preferred stock can also be used to finance the cost of
12 off-site facilities.¹⁰³ Furthermore, RR Properties argues that the Company has not shown that it needs
13 landowners to pay for 100 percent of the cost of the utility’s off-site facilities because of an inability
14 to raise capital.¹⁰⁴

15 RR Properties argues that some of the benefits of a HUF (i.e. certainty regarding the amount,
16 simplicity and eliminating disagreements and litigation) will not be realized if the Company is
17 allowed to require additional CIAC or AIAC fees for off-site facilities on top of the HUF (i.e. double-
18 dipping). RR Properties claims that the Company has not ruled out making the developer pay twice
19 –once as an advance, and a second time as a HUF.¹⁰⁵ RR Properties argues the HUF should be the
20 only money collected by the Company for off-site utility infrastructure, otherwise, there is no purpose
21 in setting a specific HUF amount.¹⁰⁶ RR Properties states that the Commission should set the HUF at
22 the level that is sufficient to collect whatever the Commission believes is the appropriate amount for
23 off-site facilities, and not allow the Company to collect any CIAC for off-site facilities over and
24 above the HUF.

25
26 ¹⁰⁰ RR Properties Reply Brief at 1.

¹⁰¹ Tr. at 640.

¹⁰² Ex I-4, Rowell Surrebuttal at 2.

¹⁰³ RR Properties Brief at 4.

¹⁰⁴ RR Properties Brief at 4.

¹⁰⁵ Tr. at 702-3.

¹⁰⁶ RR Properties Brief at 4.

1 In addition, RR Properties argues that some properties should be “grandfathered in” (i.e., the
 2 HUF should not apply) because in some cases, according to RR Properties, provision has already
 3 been made for off-site facilities. RR Properties states that it appears that the parties agree with this
 4 general principle and that the HUF should not apply to properties covered by existing main extension
 5 agreements,¹⁰⁷ but disagree as to which properties should be grandfathered.¹⁰⁸ In addition, RR
 6 Properties asserts that the HUF should not apply to subdivisions where the Company is already
 7 providing service or where the Company has accepted “on-site” facilities. RR Properties reasons that
 8 if there is no main extension agreement for such properties, then the Company has determined that no
 9 additional off-site facilities were necessary prior to service.

10 RR Properties argues that the Commission should not allow RRUI to collect additional CIAC
 11 for off-sites if the HUF is denied. RR Properties notes that Staff found that the Company has
 12 adequate capacity to serve its existing customer base and reasonable growth for the foreseeable
 13 future.¹⁰⁹ RR Properties states that it takes no position on the adequacy of the capacity, but if the
 14 Commission agrees with Staff about capacity, and denies the HUF, the Company should not be
 15 allowed to collect additional funds from developers to pay for off-site facilities because the additional
 16 off-site facilities are not needed. RR Properties argues the prohibition should apply until the
 17 Commission approves a HUF or finds that additional off-site capacity is needed.¹¹⁰

18 RR Properties states that the Company appears to seek to force developers to pay a HUF for
 19 off-sites, and then pay additional contributions or advances for the same off-sites. RR Properties
 20 questions why a HUF would be needed if the developer is being required to make two payments
 21 totaling the full cost of the plant. RR Properties believes that one of the benefits of HUF is the
 22 certainty it provides — everyone knows what the developer will have to pay. RR Properties asserts
 23 that if the Company is allowed to extract additional funds from developers for off-site facilities, that
 24 certainty will be lost.

25 RR Properties urges that if the Commission decides to approve a HUF, it should adopt the
 26

27 ¹⁰⁷ Ex I-1 at Response 2.22.

¹⁰⁸ RR Properties Brief at 5.

¹⁰⁹ Ex S-9 Liu Surrebuttal at 4.

28 ¹¹⁰ Ex I-4 at 8.

1 form of tariff proposed by RR Properties. RR Properties believes that some of the proposed language
 2 in the Company's proposed HUF tariff is unclear or creates uncertainty by allowing RRUI an open-
 3 ended right to demand future payments. For example, RR Properties cites language that speaks of an
 4 undefined "supplemental assessment" that "may" apply, and refers to "additional facilities required
 5 by the Company" and "additional requirements imposed by the Company" without limiting what
 6 those facilities or requirements may be, or when the utility may impose them.¹¹¹ RR Properties states
 7 that these provisions are not found in the Commission's standard form of HUF tariff.

8 **3. RUCO's Position**

9 RUCO objects to the following language in the Company's proposed HUF Tariff:

10 The Company shall not record amounts collected under this tariff as
 11 Contributions in Aid of Construction ("CIAC") until such amounts have
 been expended for plant.

12 RUCO asserts that CIAC is non-investor funded capital, which the Company has use of from
 13 the day the Company collects the funds. According to RUCO, these funds free-up investor-supplied
 14 capital that can be spent on other investments. RUCO asserts that the CIAC balance at any given
 15 point in time is the amount that has been collected up to that point, and Arizona ratemaking does not
 16 defer CIAC to be recorded at a later time.¹¹² RUCO asserts there are no extraordinary circumstances
 17 in this case that would warrant deferring the recording of CIAC in this case.¹¹³

18 RUCO notes that the issue of unexpended CIAC recently came before the Commission in the
 19 H2O, Inc. rate case (Decision No. 71414) and the Arizona-American rate case (Decision No. 71410),
 20 where the Commission rejected requests to include unexpended CIAC in rate base prior to the plant
 21 going into service.¹¹⁴

22 RUCO recommends that if the Commission accepts the Company's proposed HUF tariff
 23 language, the funds should be kept in a separate restricted interest bearing account with a third party
 24 financial institution, and the interest drawn on that account be treated as above-the-line "other
 25 revenues."

27 ¹¹¹ Ex I-4 at 6-7.

27 ¹¹² RUCO Closing Brief at 18.

27 ¹¹³ *Id.* at 18-19.

28 ¹¹⁴ *Id.* at 19.

4. Staff's Position

Staff recommends denying the proposed HUF tariffs. According to Staff, the purpose of hook-up fees is to equitably apportion the costs of constructing additional off-site facilities among all new service connections. Staff states that "off-site facilities" means wells, storage tanks and related appurtenances necessary for proper operation, including engineering and design costs. Staff emphasized that "off-site facilities" may also include booster pumps, pressure tanks, transmission mains and related appurtenances necessary for proper operation if these facilities are not for the exclusive use of the applicant and will benefit the entire water system.¹¹⁵ Staff states that the determination of a reasonable HUF amount is based on the off-site plant that will be needed to meet future growth divided by the ultimate number of connections that can be served by the required plant.¹¹⁶

Staff asserts that there is no need for a HUF at this time, because the Company could not identify any needed plant.¹¹⁷ Staff further contends that for the water division, there is adequate production and storage capacity to serve its existing customer base and reasonable growth for the foreseeable future.¹¹⁸ Although the Company asserted that based on its Master Plan, its storage capacity is conservative and that using the Master Plan methodology, the Company has a slight deficit, Staff claims that the Company used a number of assumptions in its Master Plan that account for the overly conservative water use data. For example, it used 341.6 gpd per unit instead of the actual water use of 310 gpd per unit and added an additional 1,000 connections, when by its own admission, its growth is flat to negative.¹¹⁹ Further, Staff notes, the Company removed the largest producing well from its calculations. Staff states that its calculations used the Company's actual water use data and concluded that the Company has not used 50 percent of its capacity.¹²⁰

For the sewer division, Staff's witness testified that the Company has adequate treatment capacity for the next three years. The Company has available to it 550,000 gallons of treatment

¹¹⁵ Staff Opening Brief at 19.

¹¹⁶ Id. citing Ex S-9 (Liu Surreb) at 2.

¹¹⁷ Ex. S-9 at 3.

¹¹⁸ Id. at 4.

¹¹⁹ Tr. at 711, 713.

¹²⁰ Tr. at 712.

1 capacity through its agreement with the City of Nogales and in the Company's service area, about
2 two-thirds of its customers are on septic systems. Staff has concerns about the amount of future
3 capacity proposed by the Company. Staff notes that in the Company's calculations, if capacity were
4 purchased from the City of Nogales, the HUF would be \$2,598 per new connection, and if the
5 Company were to build its own treatment facility, the connection fee would be \$6,667.¹²¹ Staff states
6 that the Company's inability to capture the costs for treatment for new connections supports Staff's
7 position that now is not the time for a hook-up fee.

8 In addition, Staff asserts the Company's proposed forms of tariff deviate from the standard
9 form recommended by Staff. Staff recommends that if the Commission decides to grant the
10 Company's request, that the Company be directed to use the standard form. Staff states that nothing
11 precludes the Company from filing a request for a HUF tariff when there is actually a need.¹²²

12 **5. Resolution**

13 We do not approve the Company's proposed HUF tariff. The Company has not provided
14 sufficient information about expected growth or the cost and nature of the off-site facilities needed to
15 provide service to future customers for the Commission to be able to evaluate the reasonableness of
16 the proposed HUF amounts. While the Commission may not need to know exact details about the
17 future plant that is needed to serve growth, it needs more information than has been provided in this
18 case. Without a better idea of the future plant requirements, the Commission cannot approve a fair
19 and reasonable HUF.

20 The Commission has often signaled or requested utilities to develop HUFs as a means to
21 protect current ratepayers from the costs of extending service to new customers. However, HUFs may
22 not be an appropriate financing vehicle for all utilities or every situation. Utilities overly dependent
23 on HUFs or other forms of CIAC or AIAC may find themselves with an inadequate rate base. RRUI
24 continues to be able to finance new facilities by means of Main Extension Agreements. Furthermore,
25 nothing herein prevents the Company from filing and seeking approval of a HUF tariff when it has
26 sufficient information to support the fairness and reasonableness of the charges.

27
28 ¹²¹ Staff Opening Brief at 20, citing Ex S-10, Tr. at 715.

¹²² Staff Opening Brief at 20.

1 Because we are not approving the proposed HUF Tariff, we do not address the issue of the
 2 proposed treatment to defer accounting for the HUFs as CIAC until the funds are expended on plant
 3 or whether the proposed tariff language could allow for "double-dipping." Although the CIAC
 4 treatment of the HUF funds was touched upon in this proceeding, the CIAC issue was much more
 5 fully developed in the pending rate case of RRUI's sister utilities Bella Vista Water Company,
 6 Northern Sunrise Water Company and Southern Sunrise Water Company (Docket No. W-02465A-
 7 09-0411 et al).

8 In addition, although we deny the proposed HUFs, we make no specific findings on the
 9 adequacy of capacity, and thus do not adopt RR Properties' proposal that would prohibit RRUI from
 10 collecting additional funds from developers. We make no determination on this issue at this time.

11 **E. Water Loss**

12 Staff recommends that annually, within 30 days of the end of each calendar year, the
 13 Company file reports with the Commission's Docket Control, which indicate the quantity of water
 14 pumped and sold each month during the year.¹²³ In the event the non-account water level for the
 15 Company exceeds 10 percent during a reporting period, Staff recommends that the Company report
 16 the efforts taken to reduce water loss, such as the number of leaks repaired. If after three consecutive
 17 reports have been filed, the Company's non-account water levels remains below the 10 percent
 18 threshold, Staff recommends that the reporting requirement be eliminated.

19 RRUI claims that it does not have a water loss problem; that the only time since acquiring
 20 RRUI it exceeded the 10 percent threshold was in the test year when water loss was 10.2 percent.¹²⁴
 21 The Company states that in 2009, RRUI's water loss was less than 10 percent. Nonetheless, the
 22 Company accepts Staff's non-account water monitoring recommendation.

23 Staff's recommendations are reasonable and we adopt them.

24 **F. Best Management Practices**

25 Staff states that the Modified Non-Per Capita Conservation Program ("Modified NPCCP") is
 26 a regulatory program administered by the Arizona Department of Water Resources that was added to
 27

28 ¹²³ Staff Opening Brief at 20.

¹²⁴ RRUI Reply Brief at 50.

1 the Third Management Plan for Arizona's Active Management Areas ("AMAs"). Staff states it is a
 2 performance-based program that requires participating providers to implement water conservation
 3 measures that result in water use efficiency in their service areas.¹²⁵ Staff states that providers must
 4 implement a Public Education Program and one or more additional Best Management Practices
 5 ("BMPs") based on their total number of residential and non-residential water service connections.
 6 Staff states that because the Company is in an AMA, it is subject to the requirements.

7 The Company testified that although the Company is required to have five BMPs in place, it
 8 has 10.¹²⁶ The Company submitted its BMPs in a late-filed exhibit. Staff witness Liu testified that
 9 Staff was in the process of working through the issue of processing the BMPs, but suggested that the
 10 Company submit each BMP as a tariff.¹²⁷

11 RRUI states that several of its proposed BMP's cannot be implemented by tariff.¹²⁸ The
 12 Company believes that some effort to determine which of the Company's 10 BMPs can be
 13 implemented via tariff must be made before Staff's recommendation can be granted.¹²⁹ The Company
 14 expressed a willingness to work with Staff to create a tariff.

15 The Company does not dispute the importance of conservation and the benefits of adopting
 16 BMPs. Staff has considerable experience working with companies like RRUI to document their
 17 BMPs in the form of a tariff. We will direct the Company and Staff to work together to document
 18 and implement the Company's BMPs.

19 * * * * *

20 Having considered the entire record herein and being fully advised in the premises, the
 21 Commission finds, concludes, and orders that:

22 FINDINGS OF FACT

23 1. On May 22, 2009, RRUI filed with the Commission an application for a rate increase
 24 for its water division and a rate decrease for its wastewater division.

25 2. On June 22, 2009, Staff notified the Company that its application did not meet the

26 ¹²⁵ See <http://www.azwater.gov/azdwr/Watermanagement/AMAs/documents/MNPCCPFAQs.pdf>.

27 ¹²⁶ Tr. at 673.

¹²⁷ Tr. at 757.

¹²⁸ RRUI Reply Brief at 51.

¹²⁹ *Id.*

1 sufficiency requirements outlined in Arizona Administrative Code ("A.A.C.") R14-2-103.

2 3. On June 26, 2009, RRUI filed a Response to the Letter of Insufficiency.

3 4. On June 30, 2009, Staff filed a Letter of Sufficiency indicating that RRUI's
4 application had met the sufficiency requirements of A.A.C. R14-2-103. Staff classified the Company
5 as a Class A utility.¹³⁰

6 5. By Procedural Order dated July 10, 2009, the matter was set for hearing on March 10,
7 2010, at the Commission's Tucson offices.

8 6. Intervention was granted to RUCO on July 27, 2009, and to RR Properties on August
9 21, 2009.

10 7. On December 9, 2009, RRUI filed Certification of Publication and Proof of Mailing,
11 indicating that notice of the hearing was published on August 21, 2009 in the *Nogales International*,
12 and mailed to customers on August 5, 2009, August 12, 2009, and August 29, 2009.

13 8. On December 14, 2009, Staff filed a Motion to Extend Time to file its Direct Revenue
14 Requirement Testimony, which was granted by Procedural Order dated December 15, 2009.

15 9. On December 15, 2009, Staff filed the Direct Testimony of Juan Manrique and Jian
16 Liu, and RUCO filed the Direct Testimony of William Rigsby.

17 10. On December 23, 2009, RUCO filed the Direct Testimony of Timothy Coley.

18 11. On December 23, 2009, Staff filed a Motion for Additional Time to file revenue
19 requirement/rate base testimony, which was granted by Procedural Order dated December 29, 2009.

20 12. On December 29, 2009, RR Properties filed a Motion to Extend Time to file rate
21 design testimony.

22 13. On December 30, 2009, Staff filed the Direct Testimony of Gerald Becker on revenue
23 requirement.

24 14. By Procedural Order dated January 4, 2010, the deadline for filing all rate design
25 testimony was extended.

26 15. On January 6, 2010, Staff filed the Direct Testimony of Gerald Becker on rate design.

27 16. On January 14, 2010, RR Properties filed the Direct Testimony of Matthew Rowell,

28 ¹³⁰ Pursuant to R14-103.A.3.q, each of RRUI's operating divisions is a Class B Utility.

1 and on January 15, 2010, filed an Exhibit to Mr. Rowell's testimony.

2 17. On February 1, 2010, RRUI filed the Rebuttal Testimony of Gregory Sorensen, Peter
3 Eichler and Thomas Bourassa.

4 18. On February 19, 2010, Staff filed a Motion to Extend, requesting additional time to
5 file its Surrebuttal Testimony, which was granted by Procedural Order dated February 22, 2010.

6 19. On February 24, 2010, RR Properties filed the Surrebuttal Testimony of Mr. Rowell,
7 and RUCO filed Surrebuttal Testimony of Mr. Rigsby and Mr. Coley.

8 20. On February 25, 2010, Staff filed another Motion for Extension to file its Surrebuttal
9 Testimony, which was granted by Procedural Order dated February 26, 2010. The time for RRUI to
10 file Rejoinder Testimony was also extended.

11 21. On March 2, 2010, Staff filed the Surrebuttal Testimony of Mr. Becker, Mr. Manrique
12 and Mr. Liu.

13 22. On March 9, 2010, RRUI filed the Rejoinder Testimony of Mr. Sorensen, Mr. Eichler
14 and Mr. Bourassa.

15 23. The hearing convened as scheduled on March 10, 2010, and continued on March 11,
16 12, 15 and 30, 2010.

17 24. At an Open Meeting on May 13, 2010, the Commission voted to conduct a Public
18 Comment meeting on the Application in, or near, the local service area.

19 25. By Procedural Order dated May 19, 2010, a Public Comment session was set for June
20 2, 2010, in Nogales, Arizona.

21 26. On June 2, 2010, the Public Comment Meeting convened as scheduled in Nogales,
22 Arizona.

23 27. On June 7, 2010, RRUI filed Notice of Filing Certification of Publication indicating it
24 caused notice of the Public Comment meeting to be published in the *Nogales International* on May
25 25, 2010.

26 28. The parties filed Final Schedules on April 9, 2010, their Initial Closing Briefs on April
27 19, 2010, and their Reply Briefs on May 10, 2010.

28 29. The Commission received numerous written consumer opinions opposing the

1 proposed rate increase. In addition, consumers appeared at the first day of hearing and at the
2 subsequent public comment session in Nogales to speak in opposition to the increase. In general,
3 consumers were opposed to the magnitude of the increase, especially in light of the economic
4 hardships present in the service area.

5 30. RRUI is a subsidiary of Liberty Water, and this is the Company's first rate case since
6 being acquired by Liberty Water.

7 31. In the test year, RRUI provided water service to approximately 6,600 customers, and
8 wastewater service to approximately 2,200 customers.

9 32. As discussed herein, for purposes of this proceeding, we determine that RRUI's water
10 division has an OCRB and FVRB of \$7,808,822.

11 33. As discussed herein for purposes of this proceeding, we determine that RRUI's
12 wastewater division has an OCRB and FVRB of \$3,226,898.

13 34. In the test year ended December 31, 2008, RRUI's water division experienced an
14 operating loss of \$83,485, on total revenue of \$1,847,256, for a negative rate of return.

15 35. In the test year, RRUI's wastewater division experienced operating income of
16 \$487,698 on total revenues of \$1,829,976, resulting in a 15.11 percent rate of return on FVRB.

17 36. For both the water and wastewater divisions, a rate of return of 8.74 percent is
18 reasonable and appropriate.

19 37. RRUI's water division is entitled to a gross revenue increase of \$1,261,007, or 68.26
20 percent, from \$1,847,256, to \$3,108,263.

21 38. RRUI's wastewater division is entitled to gross revenues of \$1,489,621, which is a
22 decrease of \$340,355, or 18.60 percent over test year revenues of \$1,829,976.

23 39. RRUI proposed a Low Income Tariff in this proceeding, which would give qualifying
24 participants a 15 percent discount on tarified rates. The costs of the program would be collected from
25 non-participating residential customers by means of a surcharge. Staff proposed modifications to the
26 proposed tariff, including, *inter alia*, a limit on the number of participants and using 150 percent of
27 the federal poverty level to determine eligibility.

28 40. The Low Income Tariff, and proposed surcharge mechanism as modified by Staff, is

1 fair and reasonable and should be adopted.

2 41. The record in this proceeding does not support approval of RRUI's proposed HUF
3 tariff.

4 42. Staff's recommendations as discussed herein concerning water loss reports are
5 reasonable and should be adopted.

6 43. RRUI is located in an AMA and is subject to the modified NPCCP. RRUI has
7 proposed ten BMPs pursuant to the modified NPCCP.

8 44. RRUI should work with Staff and reduce its proposed BMPs to writing and file them
9 as tariffs within ninety days of the effective date of this Order.

10 **CONCLUSIONS OF LAW**

11 1. RRUI is a public service corporation within the meaning of Article XV of the Arizona
12 Constitution and A.R.S. §§40-250, 40-251, 40-367, 40-202, 40-321, 40-331 and 40-361.

13 2. The Commission has jurisdiction over RRUI and the subject matter contained in the
14 Company's rate application.

15 3. Notice of the proceeding was provided in conformance with law.

16 4. RRUI's FVRB for its water division is \$7,808,832, and its FVRB for its wastewater
17 division is \$3,226,898.

18 5. The rates, charges and conditions of service established herein are just and reasonable
19 and in the public interest.

20 **ORDER**

21 IT IS THEREFORE ORDERED that Rio Rico Utilities, Inc. is hereby authorized and directed
22 to file with the Commission, on or before December 31, 2010, revised schedules of rates and charges
23 for its water and wastewater divisions consistent with the discussion herein for Staff's review and
24 approval.

25 IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective
26 for all service on and after February 1, 2011.

27 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc.'s proposed low income tariff, as
28 modified by Staff's recommendations, is approved; and Rio Rico Utilities, Inc. is authorized to

1 collect the costs of the program, as discussed herein, by means of a surcharge to be approved by the
2 Commission and assessed on non-participating customers.

3 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc. shall notify its customers of the
4 revised schedules of rates and charges authorized herein by means of an insert in its next regularly
5 scheduled billing, or by separate mailing, in a form acceptable to Staff.

6 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc. shall file a Low Income Tariff as
7 approved herein with its revised schedules of rates and charges, and shall within 30 days of the
8 effective date of this Order, provide notice to its customers of the Low Income Tariff and how to
9 apply, in a form acceptable to Staff.

10 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc. shall file annually, within 90 days
11 of the end of each calendar year, a report with the Commission's Docket Control as a compliance
12 item in this docket, which indicate the quantity of water pumped and sold each month during the
13 year.¹³¹ In the event the non-account water level exceeds 10 percent during a reporting period, Rio
14 Rico Utilities Company shall report the efforts taken to reduce water loss, such as the number of
15 leaks repaired. If after three consecutive reports have been filed Rio Rico Utilities, Inc.'s non-
16 account water levels remains below the 10 percent threshold, the reporting requirement shall be
17 eliminated without further Order of the Commission.

18 ...

19 ...

20 ...

21 ...

22 ...

23 ...

24 ...

25 ...

26 ...




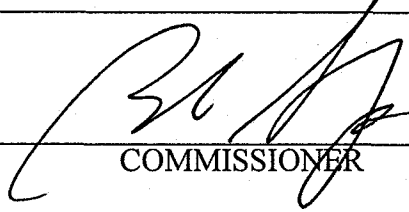
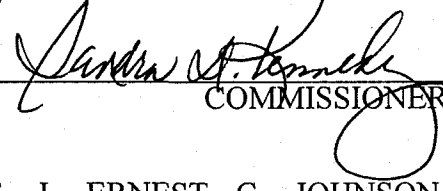
27 ...

28 ¹³¹ Staff Opening Brief at 20.

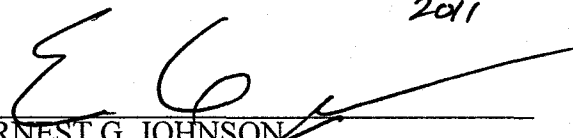
IT IS FURTHER ORDERED that within 90 days of the effective date of this Decision, Rio Rico Utilities, Inc. shall submit its ten Best Management Practices, as a compliance item in this docket, in the form of tariffs that substantially conform to the templates created by Staff (and available on the Commission's Website) for the Commission's review and consideration.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

	
CHAIRMAN	COMMISSIONER
	
COMMISSIONER	COMMISSIONER
	
	COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 6th day of JANUARY, 2010.


 ERNEST G. JOHNSON
 EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

1 SERVICE LIST FOR:

RIO RICO UTILITIES, INC.

2 DOCKET NO.:

WS-02676A-09-0257

3 Jay Shapiro

4 FENNEMORE CRAIG, PC

3003 North Central Avenue

5 Phoenix, AZ 85012

6 Attorneys for Rio Rico Utilities, Inc.

7 Daniel W. Pozefsky, Chief Counsel

RESIDENTIAL UTILITY CONSUMER OFFICE

1110 West Washington, Suite 220

8 Phoenix, AZ 85007

9 Michael W. Patten

ROSHKA DEWULF & PATTEN, PLC

10 One Arizona Center

400 East Van Buren Street, Suite 800

11 Phoenix, AZ 85004

12 Attorneys for Rio Rico Properties, Inc.

13 Janice Alward, Chief Counsel

Legal Division

ARIZONA CORPORATION COMMISSION

14 1200 West Washington Street

15 Phoenix, AZ 85007

16 Steven M. Olea, Director

Utilities Division

ARIZONA CORPORATION COMMISSION

17 1200 West Washington Street

18 Phoenix, AZ 85007